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MASTERING THE WORLD ECONOMY

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

JANUARY 13 AND 15, 1987

(Part 1 of 4)

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CONTENTS

PUBLIC WITNESSES

Page

Strauss, Robert, Akin, Gump, Strauss, Hauer & Feld, Washington, DC 35

Young, John, Chief Executive Officer and President, Hewlett-Packard Co., and Chairman, President's Commission on Industrial Competitiveness, Palo Alto, CA 84

Pratt, Edmund T., Jr., Chairman and Chief Executive Officer, Pfizer, Inc., and Chairman, Emergency Committee for American Trade 103

ADDITIONAL INFORMATION

Press release 1

Prepared statements of:

- Senator Lloyd Bentsen 2
- Senator John Heinz 13
- Robert S. Strauss 73
- Senator John Heinz 81
- Senator David Durenberger 81
- John A. Young 89
- Edmund T. Pratt, Jr 110

MASTERING THE WORLD ECONOMY

TUESDAY, JANUARY 13, 1987

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to notice, at 9:30 a.m. in room SD-215, Dirksen Senate Office Building, the Honorable Lloyd Bentsen (chairman) presiding.

Present: Senators Bentsen, Matsunaga, Baucus, Bradley, Mitchell, Pryor, Riegle, Rockefeller, Daschle, Packwood, Roth, Danforth, Chafee, Heinz, Wallop, and Armstrong.

[The press release announcing the hearing and the prepared statements of Senators Bentsen, Mitchell, Rockefeller, and Heinz follow:]

[Press Release]

FINANCE COMMITTEE CHAIRMAN BENTSEN ANNOUNCES EARLY TRADE HEARINGS

WASHINGTON, D.C.—Senator Lloyd Bentsen, Chairman, announced Thursday the Senate Finance Committee will hold four days of trade hearings beginning Tuesday, January 13, 1987.

"Trade will be my top priority as Chairman and the first major item on the Committee's agenda this year," Bentsen said.

"These initial hearings are intended to develop a national consensus on the goals of American trade policy."

"We are facing an international economic situation that has changed permanently—what French Academician Albert Bressand called the 'worldeconomy' and the United States, while no longer able to dictate economically to the rest of the world, is nevertheless the undisputed leader of the world trading system. We must, therefore, learn to master the new 'worldeconomy'."

The hearings will be held on Tuesday, January 13, 1987, Thursday, January 15, 1987, Tuesday, January 20, 1987, and Thursday, January 22, 1987.

The hearings will begin each day at 9:30 a.m. in Room SD-215 of the Dirksen Senate Office Building.

The schedule of witnesses is as follows:

January 13, 1987—Mr. Robert Strauss, former U.S. Trade Representative.

January 15, 1987—Mr. Edmund T. Pratt, Jr., Chairman and Chief Executive Officer, Pfizer, Inc.; and Chairman, Emergency Committee for American Trade. Mr. John Young, Chief Executive Officer and President, Hewlett-Packard Company; and Chairman, President's Commission on Industrial Competitiveness.

Statement by Senator Lloyd Bentsen
Senate Finance Committee Hearing
Tuesday January 13, 1987

These hearings have been called by the committee to help develop a national consensus on the goals of American trade policy.

That's one reason we've gone from a position as the world's largest creditor nation to the number one debtor in four short years.

Our trade deficit of last year is anticipated to be $173 billion, the largest ever, another record in an unbroken string of record trade deficits stretching back for five years.

This nation cannot stand that kind of a strain on its wealth. The free world needs a strong U.S. Nobody's going to give us that strength, nor should we expect them to. We must earn it. We'll have to compete for it.

We should recall that world trade expanded throughout the 1970's and nations around the globe benefitted from it. But, with the beginning of the 80's, we've seen a rise of protectionism. Country after country has denied access to its markets for our products and the products of others. World trade has been flat throughout this decade.

If the countries of Europe and Japan, in fact, would purchase the manufactured products of developing nations at the same per capita rate as the U.S. does we would see world trade expand by $250 billion a year.

In these hearings we'll be looking for answers; searching for ways to respond more quickly and effectively to unfair trade practices; searching for ways to restore reasonableness to currency exchange rates; searching for ways to encourage the industrial giants to purchase more of the exports of third world countries.

Last year, I believe this committee was prepared to markup a trade bill. We had identified the major components. We had identified the major components of the bill and had resolved through hearings and discussions many of the major outstanding issues. The Hose passed a trade bill, but the Senate was thwarted in that objective by the pressures of time and by an Administration that did not want a trade bill -- any trade bill -- to pass the Congress.

I hope that situation has changed. The President, the Secretary of Treasury and the U.S. Trade Representative have each assured me that this year the Administration wants to work with the committee in framing legislation. The President has told me he hopes to send up a bill. I am hopeful he will do so.

In the next few weeks business, labor, financial and government leaders will come before this committee to give us their best thoughts on what kind of wolrd economy the United States should be working toward and how the United States can earn its way in the new "worldeconomy."

Because of the importance of these hearings, I have scheduled only a few witnesses each day. That gives the witnesses more time to make an exposition of their ideas and it gives us more time to have a dialogue with the witnesses.

The committee is fortunate to have as its first witness today former U.S. Trade Representative Bob Strauss.

Mr. Strauss, please proceed as you will.

-30-

STATEMENT OF SENATOR GEORGE J. MITCHELL
TRADE HEARINGS BEFORE THE SENATE FINANCE COMMITTEE

JANUARY 13, 198 7

Perhaps no issue in public policy confounds this nation more today than the continuing deterioration of our international trade position. Regardless of what one believes to be the causes of our record breaking trade deficits, we all agree that Congress must examine ways to address the problem.

I am pleased that the Chairman has announced trade as the top priority of this Committee and the first item on our agenda this year. I look forward to hearing today's witness and those in the days to come.

Although this Committee did not report out a trade bill in the last Congress, we did invest considerable time and effort in reviewing the various options available for amending our trade remedy laws and fashioning an effective trade policy for the nation. All of us are familiar with the issues. I hope we can build upon what we learned last year and move without delay to approve comprehensive trade legislation.

We should, of course, not delude ourselves that the simple enactment of a trade bill will cause an immediate reversal of our trade situation. There are undoubtedly multiple reasons for our current trade difficulties. It took many years for the nation to get in the position it is in today. It will take many years to set us on a right course. But we can at least point the nation in the right direction.

Last year marked the fifth year in a row in the which the United States trade deficit reached a record level. The last month for which statistics are available, November 1986, showed another record monthly trade deficit of ~~amounting~~ ~~to~~ over $19 billion. In that one month alone, th~~e~~ nation ran a deficit that exceeded the entire yearly deficit a decade ago ~~earlier.~~

When the totals are calculated for 1986 they will likely show a trade deficit of order ~~exceeding~~ $170 billion. Perhaps the most startling figure illustrating our present difficulties is that in 1986, the total value of U.S. exports -- even in nominal dollars -- will be less than the value exported in 1980. That will mark the fourth year in a row that the value of U.S. exports has been less than in 1980.

For the latest year in which figurs are available, U.S. imports of manufactured goods exceeded manufactured exports by almost 66 percent.

Deficits of that magnitude undermine this nations welfare, reducing economic growth at a cost of millions of jobs and a lower standard of living. In industry after industry, imports are claiming a larger share of the domestic market while our export industries lose market share abroad.

If we are to effectively deal with this problem we have to realize that there are many causes of our trade difficulties, ~~involving~~ ~~relating both to policies~~ both ~~at home and abroad.~~

The American people and their elected representatives are frustrated by an international trading system where the United States is by far the largest market for almost every nation of the world while many of those same nations throw up barriers to our exports. We must respond to that problem by forcing the Administration to pursue a more aggressive trade policy that forces other nations to improve market access for our goods.

That will require that we amend the trade remedy statutes to strengthen the ability of U.S. industries to respond to unfair trade practices in other nations. And it will require a vigorous renegotiation of our current international trade rules to expand the coverage of those rules and thereby increase world trade.

We must also look at the policies of this nation which have contributed to our trade problems. That includes policies to improve the competitive position ~~environment~~ of U.S. industies.

But ~~most importantly,~~ it also means that we must change the ~~disasterous economic~~ policies which have permitted enormous budget deficits today at a cost of a lower standard of living ~~for~~ tomorrow.

We can pass all of the trade laws that have ~~ever~~ been proposed aimed at increasing exports and limiting imports and we will have not have addressed one of the ~~the~~ fundamental causes of our problems, continuing large budget deficits.

It is appropriate that this Committee, which has jurisdiction over a large part of the federal budget, including revenues, is also charged with the primary responsibility governing international trade issues. It is my hope that this Committee will exercise leadership in both areas to fashion a meaningful response to our very serious trade problems.

I look forward to hearing from our witnesses over the next couple of weeks and receiving their thoughts on how Congress can constructively deal with our international trade problems.

STATEMENT OF SENATOR JOHN D. ROCKEFELLER IV
HEARING ON INTERNATIONAL TRADE
SENATE FINANCE COMMITTEE
JANUARY 13, 1987

I sought membership on the Finance Committee because I believe that adjusting to, and competing in, the world economy is the fundamental challenge facing our country's economic future. I anticipate learning a great deal from Ambassador Strauss, the other distinguished witnesses in this set of hearings and the whole process of trying to fashion a meaningful trade legislation. Like the rest of us, however, I come to the process with certain strongly-held views.

My starting point is that our country can't go on the way it has. We are not on the road to a bright economic future; in fact, our present path is a dangerous prescription for economic decline. We urgently need to take stock and change course.

I recognize that this is not self-evident. The stock market, after all, has just broken 2000. President Reagan points with pride to the long-running economic recovery, nine million new jobs created, and the scourge of inflation apparently broken. Administration spokesmen like to speak of our trade deficit as if it were a minor cloud in an otherwise bright, blue sky.

It doesn't work that way. In a world economy, a nation's trade picture is probably the fairest measure of its economic condition--not some peripheral concern. We have changed drastically from a creditor nation to the world's largest debtor in just five short years. The trade problems facing steel and textiles have now infected all of our high-technology sectors. For the past few months, the world's greatest agricultural power has imported more food than it exported.

Our "prosperity"--such as it is--is kept afloat by massive debt at all levels: consumer debt; corporate debt; the federal budget deficits; and the trade deficit. The bottom line in this recovery is that we buy imported goods, and borrow the money from abroad to pay for them. It is an inescapable fact that a nation cannot buy $3 billion more from abroad every week than it sells--and hope to remain a prosperous nation.

My second starting point is that our trade deficit is the measure of problems that go far beyond trade, and we should not blame other countries for things that are basically within our control. If we could eliminate every trade barrier, and deal with every unfair trade practice, we would still have an enormous trade deficit--and face an enormous competitiveness challenge.

It is not the fault of the Japanese that we have massive budget deficits and a microscopic savings rate. It is not the fault of the Koreans if our kids watch "Miami Vice" instead of studying math. It is not the fault of the Taiwanese that we don't have a national commitment to retraining our workers. And it's not the fault of the Brazilians if we turn out investment bankers and lawyers, rather than teachers and scientists and engineers.

But if trade is not the whole problem, it is a serious problem. There is a stunning lack of balance in our trade relations with other countries, particularly Japan.

We negotiate painstakingly, inch by inch, year after year in an effort to open up the Japanese market to our beef, citrus, telecommunications equipment and pharmaceuticals--sectors where we have a comparative advantage. Occasionally, we seemingly make a breakthrough on market access, only to find that sales don't follow anyway. As one of our trade negotiators once described it, we push through one door only to find...another door.

At the same time, Japan has unfettered access to the world's most lucrative market for VCRs, cameras, stereos, and a guaranteed share of 20% of our automobile market. No question that the products are superb and that our consumers want them. No question that the barriers in their system are often cultural, rather than legal. But the trading relationship remains essentially one-sided, and the imbalance has serious consequences for our economy.

Obviously, many factors contribute to this situation. We have a traditional tendency to subordinate trade and economic concerns to political and strategic ones. We continue to act as if our prosperity gives us a lot of leeway in dealing with other countries. We believe, in some respects, that the national interest equates with the consumer interest in getting the widest range of products at the best possible price. We certainly feel a particular, historic obligation to stand for the principles of free trade and open markets--if not us, then who? And we believe, for the most part, that government should set the rules for international trade, and not take an interest in the outcomes or results.

Some of the considerations are valid, some partially valid, some totally obsolete. But surely it is fundamentally naive, and very dangerous, to behave as if other countries approach trade and industrial questions as we do. The truth is that other governments are intensely involved and interested in trade policy, and doing everything they can to maximize exports, minimize imports, develop industries and protect jobs. They are interested in outcomes, and not just process, and they take responsibility for those results. We may not like that different approach, but it is disastrous to pretend it doesn't exist--as the Reagan Administration often seems to.

Like every other member of this committee, I will work with the Reagan Administration if they are ready to write a meaningful trade bill and take other needed steps to address our competitive problems. I welcome every indication that they are beginning to face the real problems of our country: from Secretary Baker's effort to realign the dollar-yen relationship, to their request for more money for Trade Adjustment Assistance, to their proposal for a larger budget for the National Science Foundation.

But this Administration has a lot to answer for in the areas of trade and competitiveness. Passing the irresponsible and inequitable 1981 tax cut, which left us with staggering budget deficits...Praising the "strong dollar" in 1983 and 84 while our manufacturers were moving overseas because they couldn't afford to do business here...Standing by while half the country's steel jobs disappeared in just five years. Putting the Young Commission report on the shelf to gather dust, because the Commission said it wasn't "morning in America"...Abandoning our efforts to build a national energy policy...Refusing to use Section 301 to deal with our trade problems...Overturning the ITC when beleaguered industries played by the rules and sought trade relief under section 201.

And if I sound bitter, it comes from having been Governor of West Virginia during the Reagan recession: when workers lost their jobs, for reasons far beyond their control, the Administration slashed unemployment benefits, opposed trade adjustment assistance, and told them if they didn't like it, they could "vote with their feet."

The truth is that the Reagan Administration has presided over a precipitous decline in our country's competitive position in the world. Where our nation's competitiveness has been concerned, to put it most generously: these have been wasted years.

Wasted--because it was the right time to have done so much. Americans grasp the competitiveness challenge, almost intuitively. States are working to improve their schools and level of technological innovation; corporations are radically restructuring; labor and management are increasingly inclined to work together to improve productivity. But it is difficult to mobilize a nation of 240 million without government leadership, and it is impossible to compete in the world without government policies that give our businesses and workers the support they need.

I think we can write a trade bill that can make a difference to our country, although the Administration could have done a far better job than it has with the tools already at hand. Whatever trade bill we enact, however, must be part of a wide-ranging effort to enhance our nation's competitiveness. Paula Stern, outgoing Chair of the ITC, put it well in a speech last year: Trade is important, but competitiveness is the key. We should always oppose unfair trade practices, but we should worry less about the level of the playing field and more about the quality of the American team. And we cannot continue to drift, while other nations chart a strong course.

SENATOR JOHN HEINZ
COMMITTEE ON FINANCE — HEARING ON INTERNATIONAL TRADE
JANUARY 13, 1987
OPENING STATEMENT

MR. CHAIRMAN, I WELCOME THESE HEARINGS BECAUSE THEY REPRESENT THE BEGINNING OF OUR EFFORT TO WRITE MAJOR TRADE LEGISLATION. I SUPPORT THAT EFFORT WHOLEHEARTEDLY. IT IS LONG OVERDUE.

THE TIME FOR DEBATE HAS LONG SINCE PASSED. WE HAVE VISITED AND REVISITED THE ISSUE OF THE TRADE DEFICIT. IN 1986 THE RISING TIDE OF RED INK ROSE TO $170 BILLION. IT IS TIME TO STOP PLEADING, CAJOLING AND THREATENING IN THE VAIN HOPE THAT OUR TRADING PARTNERS WILL COME AROUND.

I HOPE THESE HEARINGS WILL EXPOSE SOME OF THE MYTHS ABOUT THE TRADING SYSTEM THAT HAVE HELD US BACK FROM LEGISLATING. THOSE MYTHS INCLUDE:

FIRST, THAT THE CURRENT SYSTEM IS BASED ON FREE TRADE. THE MOST ELOQUENT REBUTTAL OF THAT COMES FROM THE ADMINISTRATION'S REPORT ON FOREIGN TRADE BARRIERS -- 300 PAGES OF EVIDENCE SHOWING THAT OTHER COUNTRIES ARE GETTING AWAY WITH ECONOMIC MURDER BY IGNORING THE LAW OF COMPARATIVE ADVANTAGE.

WITHOUT QUESTION THE BEST KNOWN PROTECTIONIST NATION IS JAPAN. I DON'T WANT TO BORE ANYONE WITH A LONG LIST, BUT THE UNITED STATES HAS HAD MARKET OPENING OR TRADE BARRIER NEGOTIATIONS WITH THEM ON ELECTRONICS, PHARMACEUTICALS, TOBACCO, ALUMINUM, MEDICAL EQUIPMENT, TELECOMMUNICATIONS, FOREST PRODUCTS, TRANSPORTATION MACHINERY, SEMI-CONDUCTORS, LEATHER, COMPUTERS, WINE AND LIQUOR, CHOCOLATE, CONSTRUCTION SERVICES, AND NUMEROUS AGRICULTURAL PRODUCTS. ALL WITH AT BEST MODEST BENEFIT.

OF COURSE JAPAN IS NOT THE ONLY EXAMPLE. THE USTR REPORT ALONE LISTS 39 OTHER COUNTRIES AND DOES NOT EVEN GET TO THE EASTERN BLOC.

THE SECOND MYTH IS THAT THE SHRINKING DOLLAR WILL CURE ALL ILLS.

ALTHOUGH THE DOLLAR HAS DROPPED APPROXIMATELY 25 PERCENT FROM ITS PEAK AGAINST A BASKET OF CURRENCIES, IT HAS NOT DROPPED SIGNIFICANTLY AGAINST A NUMBER OF VERY IMPORTANT CURRENCIES: CANADA, SINGAPORE, KOREA, TAIWAN, AND HONG KONG.

AGAINST OUR 17 LARGEST TRADING PARTNERS, THE DOLLAR HAS DEPRECIATED ONLY 4% FROM ITS PEAK IN FEBRUARY 1985. AGAINST THE SEVEN LARGEST OF THOSE TRADING PARTNERS WHICH NOW ACCOUNT FOR 61 PERCENT OF OUR TRADE, THE DOLLAR DIDN'T GO DOWN; IT WENT UP 11 PERCENT.

THIS SITUATION IS COMPOUNDED BY THE FACT THAT EVEN IN THOSE COUNTRIES WHERE THE CURRENCY HAS APPRECIATED VERSUS THE DOLLAR, THERE IS LITTLE INTEREST IN ABSORBING THE EFFECTS OF THE APPRECIATION. PRODUCERS CONTINUE TO FOCUS ON MAINTAINING MARKET SHARE RATHER THAN PROFIT LEVELS.

IN THE STEEL INDUSTRY, FOR EXAMPLE, JAPANESE STEEL PRICES OVER THE LAST 14 MONTHS DECLINED 7.5 PERCENT WHILE THE YEN WAS GOING UP SOME 22%.

STEEL, OF COURSE, IS ONLY ONE EXAMPLE. THE WORLD IS AWASH IN EXCESS CAPACITY MADE WORSE BY GOVERNMENT DETERMINATION TO MAINTAIN PRODUCTION FOR POLITICAL RATHER THAN ECONOMIC REASONS. TO CONTINUE TO BELIEVE THAT A DECLINE IN THE DOLLAR ALONE CAN HAVE A SIGNIFICANT IMPACT ON REVERSING OUR CURRENT FORTUNES IS TO MISUNDERSTAND TOTALLY WHAT HAS BEEN GOING ON IN THE GLOBAL ECONOMY.

THE THIRD MYTH IS THAT THERE IS NOTHING CONGRESS CAN OR SHOULD DO ABOUT ANY OF THIS.

THAT REMAINS TO BE SEEN BUT CAN HARDLY BE TAKEN AS A GIVEN. THE RECORD OF WHAT CONGRESS HAS ACTUALLY ENACTED INTO LAW OVER THE PAST 20 YEARS IS AN EXTRAORDINARILY RESPONSIBLE ONE. IN SOME RESPECTS MORE RESPONSIBLE THAN THAT OF ADMINISTRATIONS DURING THE SAME PERIOD.

THAT MEANS THE CASE AGAINST TRADE LEGISLATION IS HARDLY PROVED. ON THE OTHER HAND, THE CASE FOR IT MUST BE DEMONSTRATED. THE PROOF LIES IN THE WORLD TRADING SYSTEM AS IT EXISTS IN REALITY -- NOT IN MYTH.

THAT REALITY IS THAT THE UNITED STATES UNDERTOOK, IN THE AFTERMATH OF WORLD WAR II, A POLICY THAT WAS AT THE TIME VERY MUCH IN OUR SELF INTEREST. WE ENGAGED IN A POLICY OF REBUILDING THE SHATTERED WESTERN WORLD THROUGH THE CREATION OF A STRONG WESTERN ALLIANCE -- BOTH ECONOMIC AND POLITICAL. IN 1945, WE ACCOUNTED FOR 60% OF THE FREE WORLD'S GROSS NATIONAL PRODUCT. IT WAS IN OUR INTEREST TO PROMOTE TRADE AND INVESTMENT -- THE COST TO US WAS SMALL AND THE GAIN GREAT.

BUT OVER THE LAST 40 YEARS, THAT POLICY HAS SUCCEEDED WITHOUT US FULLY UNDERSTANDING ITS IMPLICATIONS. OTHER COUNTRIES HAVE DEVELOPED THEIR OWN PATHS TO THE MERCANTILIST POLICIES I HAVE DESCRIBED. THEY HAVE ESSENTIALLY CAUGHT UP AND GONE BEYOND US IN COMPETITIVENESS AT THE VERY TIME OUR OWN REAL GROWTH OF STANDARD OF LIVING HAS SLOWED DOWN.

AND HAVING DONE SO, THEY HAVE NEITHER MET THEIR NEW RESPONSIBILITIES, NOR HAVE THEY ADDRESSED THE NEW PROBLEMS THESE POLICIES HAVE CREATED.

EXCESS CAPACITY HAS BECOME A GLOBAL DISEASE. THE TRADITIONAL EXPLANATIONS FOR OVER CAPACITY ARE RISING PRODUCTIVITY AND WEAK DEMAND. ADD TO THAT:

-- INCREASING GOVERNMENT SUBSIDIES THAT KEEP THE INEFFICIENT IN BUSINESS;

-- THE RELUCTANCE OF HIGH TECH PRODUCERS TO SHUT DOWN COSTLY PRODUCTION FACILITIES WHEN DEMAND SLACKENS,

-- THE NEW OBSESSION WITH MAINTAINING MARKET SHARE AT THE EXPENSE OF PROFITS AND PRICES;

-- THE GLOBALIZATION OF CAPITAL AND TECHNOLOGY MOVEMENTS THAT BRING ON NEW CAPACITY IN UNEXPECTED LOCATIONS.

THIS IS NOT A TEMPORARY DETOUR ON THE ROAD TO FREE TRADE. DEVELOPMENT MEANS THE CONTINUING EXPANSION OF NEW PRODUCERS, BUT IT DOES NOT GUARANTEE AN EQUAL GROWTH OF CONSUMPTION. THE RESULT IS GAIN FOR SOME AT THE EXPENSE OF MORE MARKET-ORIENTED PRODUCERS. SO FAR THE CHIEF VICTIM HAS BEEN THE UNITED STATES.

TODAY WE ACCEPT 40 PERCENT OF ALL KOREA'S EXPORTS. OF JAPAN'S - 40%, OF TAIWAN'S - 50%, OF CANADA'S - 80%, AND OF LDC'S - 58%. WE HAVE BEEN, AND WE CONTINUE TO BE, THE ENGINE OF GROWTH FOR THE FREE WORLD.

WHILE THAT WAS THE RIGHT POLICY FOR ITS TIME, IT IS ONE WE QUITE FRANKLY CAN'T AFFORD ANYMORE, BECAUSE OUR ENGINE IS FUELED BY DEBT: NATIONAL DEBT, TRADE DEBT, CONSUMER DEBT, BUSINESS DEBT, AND OVER LEVERAGING. IT IS LOW-OCTANE FUEL THAT IS PRODUCING LESS AND LESS HORSEPOWER TO DRIVE THE TRAIN.

THE CONSEQUENCES OF ALL THIS ARE BEGINNING TO SHOW. SINCE 1973, AMERICANS HAVE BEEN LIVING HIGHER ON THE HOG WHILE THEY'VE BEEN GETTING POORER. SINCE 1973, REAL PER CAPITA MANUFACTURING WAGES HAVE DECLINED APPROXIMATELY 14 PERCENT. REAL MANUFACTURING WAGES TODAY ARE LOWER THAN THEY WERE IN 1961.

AND IN THE PRESENT SYSTEM, IF WE RUN OUT OF GAS, EVERYBODY'S CAR STALLS -- UNLESS WE HAVE A MORE EQUITABLE DIVISION OF RESPONSIBILITY IN THE TRADING SYSTEM. THE BEST BASIS FOR THAT IS THE MARKET SYSTEM. THAT IS WHAT IS BEHIND THE CONCERN IN CONGRESS FOR TRADE LEGISLATION: THE CREATION OF A REGIME THAT REALLY DOES ENFORCE THE NOTION OF FREE TRADE. WE DON'T HAVE IT NOW. AND WE DESPERATELY NEED IT.

THAT MEANS WE HAVE TO MOVE VIGOROUSLY TO ATTACK UNFAIR TRADE PRACTICES WHEREVER WE FIND THEM. OF COURSE IT IS TRUE THAT FROM AN EXTREME SHORT-TERM PERSPECTIVE THAT, WILL MAKE ONLY A MODEST DIFFERENCE IN THE TRADE DEFICIT. BUT JUST AS IT TOOK 20 OR 30 YEARS FOR US TO GET WHERE WE ARE NOW, IF WE REALLY WANT THE LONG-TERM BENEFITS OF COMPARATIVE ADVANTAGE AND THE FREE MARKET IT'S GOING TO TAKE 10 OR 15 YEARS TO SEE THEM, EVEN IF WE COULD CREATE THE PERFECT CONDITIONS TOMORROW.

ALL THOSE COUNTRIES THAT HAVE SENT THEIR EXPORTS TO US AND GROWN AS A RESULT OF THESE POLICIES, WILL NOT CHANGE EASILY. WHY SHOULD THEY? THE CURRENT SYSTEM IS A BRILLIANT SUCCESS FOR THEM. WE ARE THE LOSERS, NOT THEY. THIS MAY BE WHY WE OUGHT NOT TO EXPECT TOO MUCH FROM THE NEW GATT ROUND -- THE EC, JAPAN, AND THE NEW INDUSTRIALIZING COUNTRIES HAVE LITTLE MORE TO GAIN AND A LOT TO LOSE IN ANY MOVE TOWARD REAL FREE TRADE.

WHY SHOULD WE DO IT? BECAUSE IF WE DON'T ONE OF TWO THINGS WILL HAPPEN:

1) EITHER OUR COMPETITIVE POSITION WILL CONTINUE TO ERODE AND OUR DEBT CONTINUE TO INCREASE PAST THE POINT WHERE FUNDAMENTALS LIKE OUR NATIONAL SECURITY AND ECONOMIC INFRASTRUCTURE ARE AT RISK; OR

2) THERE WON'T BE A MARKET SYSTEM AT ALL, AND WE WILL FIND OUR GOVERNMENT STEPPING IN AND RUNNING THINGS.

THAT IS WHAT IS DRIVING TRADE LEGISLATION IN CONGRESS -- NOT JUST FRUSTRATION OVER THE PRESENT BUT REAL CONCERN FOR THE FUTURE. MUCH OF WHAT HAS HAPPENED IS IRREVERSIBLE. JOBS LOST WILL NEVER BE REGAINED. DEAD INDUSTRIES WILL NOT BE RESURRECTED. THAT MEANS, OBVIOUSLY, ADJUSTMENT LEGISLATION WILL BE A MAJOR PART OF WHAT WE DO. THAT IS THE

PROPER WAY TO ADDRESS THE SHORT TERM. BUT SALVAGING THE LONG TERM WILL BE THE CORE OF OUR WORK. THAT WILL MEAN MANY OF THE THINGS THAT HAVE BEEN PROPOSED UNDER THE UMBRELLA OF COMPETITIVENESS. BUT IT WILL ALSO MEAN AN ALL-OUT ASSAULT ON TRADE BARRIERS WORLDWIDE. DURING THESE HEARINGS I WILL BE WORKING TO SHAPE TRADE LEGISLATION THAT ADDRESSES U.S. COMPETITIVENESS AND DISMANTLES WORLDWIDE TRADE BARRIERS.

The Chairman. The committee will come to order.

I would like to advise the members that we will try very much to start on time. If there is one member here, we will start the meetings from now on at that time.

We will also observe the early bird rule in trying to encourage early attendance.

This morning we will have opening statements. I ask that you limit them to five minutes, and if you have some extra time to give back that will be appreciated.

One of the members wanted to know if he could bank that and one of the others advised him no, it was fungible.

These hearings have been called by the committee to lay a foundation for a new trade bill in 1987. Last year, I believe the committee was prepared to do a markup on a trade bill. It identified the major components of that bill, and had resolved through hearings and discussions many of the major outstanding issues.

The House passed a trade bill. But here in the Senate, we were thwarted in that objective by the pressures of time and by an Administration that at that time did not want a trade bill.

I hope and I believe that situation has changed. The President, the Secretary of State, the U.S. Trade Representative and the Secretary of Treasury have advised me that the Administration wants to work with the committee in framing legislation. The President has told me he hopes to send up a bill, and I am hopeful that he will do so.

This year, the process of trade legislation has begun in earnest and I believe that we are going to meet with success and have a trade bill.

The heart of the trade bill has to be the authority for the new round of trade negotiations. The President's existing authority has less than a year to run, and it is geared to the problems of the 1960s and not the 1980s.

Therefore, to begin the process of legislating on trade, we must arrive at a national consensus on the objectives of American trade policy and the strategies that we will use to try to change those objectives.

In the next few weeks, business, labor, financial and government leaders have agreed to come before the committee to give us their best thoughts on what kind of world economy the United States should be working toward and how the United States can earn its way in the new "worldeconomy."

Because of the importance of these hearings, I have scheduled only a few witnesses each day. I want the interplay; I want the chance for you each to be able to follow up in discussing the issues involved with that particular witness. That will give those witnesses more time to make an exposition of their ideas and us, in turn, to have a dialogue with that witness.

I think the committee is very fortunate to have as its first witness the former U.S. Trade Representative, Bob Strauss, and we will be calling on him just as soon as I give my colleagues a chance to make their comments.

And following that early bird rule, I note that Mr. Heinz will be the first to make his comments.

Senator **Heinz**. Mr. Chairman, first, I want to commend you on the hearings you are having on trade. It is my hope that they will not only be excellent hearings but they will produce the kind of legislation that this committee has shown it can put together and pass on previous occasions.

I would like to make a couple of brief observations of a philosophical nature regarding the status of our thinking on trade.

It is my belief that we are captive to several myths about trade. The first is that the current system is based on free trade. The most eloquent testimony rebutting that assumption comes in the form of a 300-page report from the Administration listing trade barriers. The most pages in that report are dedicated to Japan and Brazil. And the ones on Japan and some of the other newly industrializing countries are quite extraordinary and far reaching in revealing the inventiveness and creativity of the trade barriers these countries have devised.

We should not be fooled into thinking, therefore, that the world plays by the same rules that we want to play by and have been playing by.

The second myth—and it is one that we have heard from both Republicans and Democrats—is that the shrinking dollar, the weakening of the dollar in international trade, is going to solve most of our trade problems. Many have noted that the dollar has declined some 25 percent from its peak. That is a little misleading because if you look at our seven largest trading partners who account for some 61 percent of the trade we do internationally, the dollar has not dropped; it has not weakened. It has actually strengthened against those currencies by 11 percent.

And even where you have had a weakening of the dollar relative to a currency such as the Japanese Yen where the Yen has strengthened 38 percent relative to the dollar; nonetheless, Japanese marketers are following policies to cling to their share of markets rather than to allow the currency changes to affect the balance of trade.

So in an industry like steel you find that instead of Japanese prices increasing over the last year and a half, they have actually declined by seven and a half percent while the Yen was increasing.

Mr. Chairman, the third myth is that we will not, or should not, or cannot do anything about any of this. I think we have a responsibility to look very hard and to take appropriate action to defend the market system for two reasons:

One, if we do not, we will simply find the United States out of business, or two, we will find ourselves becoming like the government-run, government-financed, and government-owned enterprise economies of the developing world, and we will not be the same country we are today or once were.

Mr. Chairman, I commend you again on these hearings.

The. **Chairman**. Thank you very much.

And I now call on Senator Armstrong. Did he step out for a moment?

Senator **Wallop**. He went to the Budget Committee.

The **Chairman**. All right.

Mr. Baucus.

Senator **Baucus**. Thank you, Mr. Chairman.

I think at this point it would be appropriate to commend you as the new chairman of the Finance Committee. I did a little research here, in fact, and found that there have been some terrific Texans sent to the United States Senate—Henry Clay, for example—but only one is now the chairman of the Finance Committee. You are the first Senator from Texas who is chairman of the Finance Committee. I know that you will serve this Senate as chairman of the Finance Committee in the same way that other very distinguished chairmen of the Finance Committee have, Henry Clay, for example, and Daniel Webster.

We have also been blessed, as you know, with the chairmanship of Senator Long, Senator Packwood, Senator Dole, and I think all of us very much look forward every bit as much our new chairman.

The CHAIRMAN. Senator Baucus, I very much appreciate your objective statement and you will do well on this committee. [Laughter.]

Thank you.

Senator BAUCUS. Mr. Chairman, it is due to your guidance that I have learned that lesson over the years.

I think this morning it is important to focus on a couple of points with respect to trade and our trade deficit. One is that it is often said that the world is changing. Mr. Chairman, I don't think that the world is changing at all. It has changed. It is already changed and it has changed dramatically, drastically. There are various examples of that. One is the trade deficit that we all know about, and there are many other indications as well.

As we try to find a solution to our trade deficit, I think it is important that we be honest with ourselves and recognize that, at least as I see it, it is broken down to four different categories. One is obviously the unfair trade practices of other countries.

It is clear that after World War II we were the engine that built the world with the Marshall Plan and helped Japan and other countries. We provided most of the incentives to build growth in the world. In the meantime, those countries took advantage of us, as well they would. If we had been in their shoes we probably would take certain actions to help ourselves too.

Many of those countries continue those unfair trade barriers. For example, Korea does not allow any automobiles to be imported into Korea. Japan still has very severe limits on citrus and beef. Other countries have their restrictions. Obviously this is one problem we have to address. It is a very severe problem.

In addition, I think it is clear that our trade deficit is due to currency misalignments. We all know the overvalued U.S. dollar has raised havoc with our export market. But I think the Administration is to be commended. They have done a great job with getting the G–5 and the G–7 together to bring the dollar down in comparison with the Yen and the Mark.

Unfortunately, there are many other countries whose currencies are not in line, whose currencies are somewhat tied to the dollar, or else countries who take actions that do not allow their currencies to be realigned. I am thinking of Taiwan, Korea, Brazil, and to some degree, Canada. So that's the second part of the problem, currency misalignment. We have to realign currencies and provide more currency stability.

I think there is a third major problem and that is the lack of world demand, sluggish world demand. Third World debt overhang is certainly a part of it. In addition to that, Japan and Germany just haven't grown or stimulated their economies the way they should.

So that is the third component of our massive trade problem.

There is one final component which I think we have to address. That is competitiveness. We have heard a lot about competitiveness these days. Some people say it is a buzz word; some people wonder what it is. I am often asked what it is.

So today, Mr. Chairman, I have a little chart over here and it is entitled "What is this competitive stuff all about anyway?"

As we can see, it is really broken down into various categories. These are just some of the major components, but there are several.

Assisting displaced workers. We know the problem here because there were various remedies proposed by many.

Education. It is clear that we have to educate our people better.

R&D. It is clear that our R&D efforts are falling behind those of other countries.

Capital investments. We all know that capital costs in our country are way above what they should be. Japan's is about one-third that of ours.

Export promotion. Most other countries on a per capita basis spend 15 to 16 times more on export promotion than we do.

The final one is changing attitudes. If I might, Mr. Chairman, the next chart, please, very quickly.

The next chart just shows one component of the problem, namely, how much of our R&D is spent on civilian R&D and how much of it is spent on Defense.

The black bar on the left shows total R&D expenditures as a percent of GNP—that is private and government—for all countries. You can see they approach a limit of about 2.6 percent. That is total, private and government.

If you break down the total into the two components, civilian and military, you see that U.S. civilian R&D is about 75 percent of the total, whereas in Japan and Germany it is about a hundred percent, close to a hundred percent of their total.

My only point is that since World War II the world has dramatically changed, and we as a people, we as a country, have to begin to rethink how much of our effort is devoted not only to military security but to economic security. These are some of the components of competitiveness. I hope that when people ask what competitiveness is all about, they will begin to look at some of these areas because I think competitiveness is a fourth major component, in addition to unfair trade barriers, that we have to address.

The CHAIRMAN. Thank you, Senator Baucus.

And I would now like to call on Senator Packwood, the former distinguished chairman of this committee, and one whom I enjoyed working with very much over the last term of the Congress, and will be looking forward to working with him again. Senator Packwood.

Senator PACKWOOD. Mr. Chairman, thank you.

Just before the meeting, Senator Bentsen and I were talking, and he said he had to cancel a trip that he had planned to Geneva and elsewhere after the elections in order to take the time to prepare for the chairmanship of this committee. And I told him, given my druthers, I wish he had had time for the trip. [Laughter.]

It is a rare privilege to be chairman of this committee, and I am going to do everything I can to make sure that Senator Bentsen is a strong chairman, because I have discovered in negotiating with the House or in negotiating with other interests outside the Congress, if the chairman comes with divided authority or weak followers, he is not in a position to bargain. And so you will have my support on everything that I can conceivably do to help.

The CHAIRMAN. Thank you so much, Bob.

Senator PACKWOOD. Last year when we came out of this committee with the tax bill, and with the Super Fund bill, and with the free trade agreement with Israel, and even with the agreement to negotiate with Canada, although the committee was split, it was not a partisan split.

The committee, by and large, has been pretty good about standing behind the chairman when decisions were made.

On this issue, I told the chairman earlier that I think it is a tougher issue than tax. On tax, at least you had the bulk of the committee, the bulk of the Congress and the bulk of the President sort of thinking in the same direction. Some differences as to some minutia, but by and large thinking in the same direction. I am not sure that is true of the House, and the Senate, and the Administration, or Republicans and Democrats, or industrialized state representatives versus agricultural state representatives, on the issue of trade. And it is going to be a tougher job to pull the Congress together to attempt to get a bill that the President can sign because I fear if he vetos one it would probably be sustained and we would have nothing. And we need something.

And in my experience, this country is about one-third protectionist, and I mean that in the traditional sense of the word. We are a big country, 240–250 million people: put up the barriers. We won't sell any computers overseas and we won't buy any Toyotas. We will only buy raw materials in short supply and we will just trade internally. Sort of a gigantic American common market. That will not do. We cannot live in that world, or we will become very uncompetitive and see a gradually declining standard of living if we attempt to live in that world.

But you couple that one-third protectionist feeling with bad times in certain industries—and there are bad times in certain industries—and you have got close to a majority in the Congress and in the country that is ready to pass a bad protectionist bill.

We all represent different states, and different interests, and when we forget that, when we forget we are a Senator from Oregon or West Virginia or Rhode Island, we often don't come back.

And the burdens of expanded trade, if we can achieve it, do not fall equally on all states. And that is why retraining and job assistance and ways to ease the burden of expanded trade are critical.

In my state, Oregon, trade is a big employer. We have over 10,000 people employed in the sole industry of importing automobiles, importing them. So when anyone talks about putting restrictions on trade, imports or exports for Oregon, they are talking about losing jobs.

It is our third or fourth largest employer in the state. I just mean what comes in over the docks and what goes out over the docks or is insured or is prepared for export or service and prepared after it has been imported.

So I will do what I can to defend my state, but, equally importantly, I am convinced that under Senator Bentsen's leadership we can reach a trade bill that will be good for this country, that will include the elements to ease the transition for those for whom trade is understandably difficult. And the chairman will have my full cooperation in achieving that end.

The CHAIRMAN. Thank you very much, Senator.

Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman. I am delighted to be serving with you on this committee. I sought membership in the Finance Committee because I believe that adjusting to, and competing in, the world economy is the fundamental challenge of our country's economic future.

My starting point is that our country cannot go on the way that it has. We are not on the road to a bright economic future, in my judgment. In fact, our present past is a dangerous prescription for economic decline.

We urgently need to take stock and to change course. I recognize that this is not all self-evident. President Reagan points with pride to the long running recovery. However, our prosperity, such as it is, is kept afloat by massive debt at all levels: consumer debt, corporate debt, the federal budget deficit and the trade deficit. The bottom line in this recovery, to me, is that we buy imported goods and we borrow the money from abroad to pay for them.

It is an inescapable fact, in my judgment, that a nation cannot buy $3 billion more from abroad every week than it sells and expect to remain a prosperous nation.

My second starting point, Mr. Chairman, is that our trade deficit is the measure of problems that go far beyond trade and that we should not blame other countries for things that are basically within our control.

If we could eliminate every trade barrier and deal with every unfair trade practice, we would still have an enormous trade deficit. It is not the fault of the Japanese that we have a massive budget deficit and a microscopic savings instinct. It is not the fault of the Koreans that our kids watch Miami Vice instead of studying math. It is not the fault of the Taiwanese that we don't have a national commitment to retraining our workers, and it is not the fault of the Brazilians that we turn out investment bankers and lawyers rather than teachers, scientists and engineers. But if trade is not the whole problem, it is a serious problem. There is a stunning lack of balance in our trade relation with other countries, particularly Japan.

We negotiate painstakingly, inch by inch, year after year, in an effort to open up the Japanese market to our beef, citrus, telecommunications equipment and pharmaceutical sectors where we, in fact, do have a comparative advantage. Occasionally we seem to make a breakthrough on market access only to find that sales do not follow.

As one of our trade negotiators once described it, we push through one door only to find another. At the same time, Japan has unfettered access to the world's most lucrative markets for VCRs, cameras, and stereos, and a guaranteed share of 20 percent of our automobile market. There is no question that the products are superb and that our consumers want to buy them and no question that the barriers in their systems are often cultural and not legal. But the trading relationship remains essentially one-sided, and the imbalance has serious consequences for our country.

Surely it is fundamentally naive and very dangerous to behave as if other countries approach trade industrial questions as we do. The truth is that other governments are intensely involved and interested in trade policy and are doing everything they can to maximize exports, minimize imports, develop industries, and protect their jobs.

They are interested in outcomes, not just process, and they take responsibility for the results. We may not like that different approach, Mr. Chairman, but it is disasterous to pretend that it does not exist.

Like every other member of this committee, I will work with the Reagan Administration if they are ready to write a meaningful trade bill and take other needed steps to make us more competitive. But, quite frankly, this Administration has a lot to answer for in the areas of trade and competitiveness.

Passing the inequitable 1981 tax cut left us with staggering budget deficits. Praising the strong dollar in 1983 and 1984 while our manufacturers were moving overseas because they could not afford to do business here. Standing by while half the country's steel jobs disappeared io just five years. Putting the Young Commission report on the shelf to gather dust because it did not report that it was morning in America. Abandoning our efforts to build a national energy policy. Refusing to use Section 301 to deal with our trade problems. Overturning the ITC when beleaguered industries playing by the rules sought trade relief under Section 201.

If I sound bitter, Mr. Chairman, it comes from having been Governor of the State of West Virginia during the Reagan recession. When workers lost their jobs for reasons beyond their control, the Administration slashed unemployment benefits, opposed trade adjustment assistance, and told them if they did not like it they could vote with their feet.

Mr. Chairman, I think we can write a trade bill, and I think we can write a trade bill that will make a difference. I stand ready to work with you and with this committee in this effort. Whatever trade bill we will enact, however, must be part of a wide ranging effort to enhance our nation's overall competitiveness, and we cannot continue to drift while other nations chart a strong course.

I thank the chairman.

The CHAIRMAN. Thank you very much, Senator Rockefeller.

Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

First of all, I want to commend you for holding these hearings and getting started on this. Second, I want to say, as far as the last remarks go, I don't think we are going to get anywhere if we are going to start blaming the Reagan Administration for the trade deficits of this country. And, indeed, I think we owe a deep debt of gratitude to our President who vetoed a protectionist piece of legislation that would have started us down on a road that would have been very difficult to come back from. So I think that as far as these hearings go on this committee, and our whole action, we want to work with the Administration if we are going to get anywhere.

There is plenty of blame to go around all over the place and I am not prepared to countenance the suggestion that it is the Reagan Administration that is responsible for the situation that we are in now.

Now we are all aware that we have had a tremendous trade deficit in the past year, $170 billion. And there are many reasons. The strong dollar, increased foreign investment in the U.S. But as Senator Baucus has mentioned, one of the things that we have got to get on with here is increasing our competitive position. And it was pointed out in these charts; there is a lot that goes into that. Certainly one of them is going to deal with the matter of trade. That is part of competitiveness.

Now I hope that we can reform our trade laws, and not in the lines of increased protectionism, but to the contrary, to gain increased market access.

Everybody I think perhaps undoubtedly saw the Congressional Budget Office report in November of 1980 which confirmed the fact that we have long believed, trade protection has not helped revitalize domestic industry such as steel, footwear, automobiles, apparel, textiles.

If you look over the goods that this country manufactures, those very areas have had more protectionism than any others, and the result has not improved their situation. They are still disaster areas.

Now what I want this bill to be is along the lines that the chairman has discussed already, namely, to be more responsive to the unfair trade practices overseas and the lack of access for our superior goods.

Billions of dollars in market opportunities for U.S. firms here and abroad are lost each year because of the unfair trading practices of our competitor nations. These practices thwart our most competitive companies whether they are in high technology, communications or services. And we have got to insist that there be a forceful approach to these unreasonable practices.

As a nation, we have been unwilling to enforce aggressively our right under existing trade laws. And this is true with every Administration. It isn't true of this Administration; it is true of the prior Administration. The lack of the use of Section 301. Trade is too large a part of our economy today to allow other interests to always take priority when it comes time to make policy decisions.

Last year I sponsored a bill with Senator Bradley, S. 1862, designed to eliminate these barriers and distortions to trade by giving new authority to the U.S. Trade Representative to initiate cases and requiring that he take action after a certain time period.

In addition to taking stronger action with regard to unfair trade practices, we need to consider other laws which have had effect on our trade. We need to examine our antitrust laws and our export control policies.

Just this week—yesterday, as a matter of fact—I believe everybody saw the study by the National Academy of Sciences that found attempts to keep high technology from Soviet-bloc nations have not significantly improved America's national security. But it cost this nation approximately 188,000 jobs and $9 billion in 1985 alone.

Foreigners have practically unlimited access to our government-owned, government-operated laboratories, for example. But we don't enjoy such privileges abroad neither in the European community nor in Japan.

Developing nations require that we transfer technology before they permit us access to their markets. And these same nations also pirate our intellectual property. And that is why, with Senator Bentsen, I joined in the introduction of S. 2663, concerning this inequity in technology flow. And I hope we can address that in this comprehensive bill we are working on now.

So, Mr. Chairman, I look forward to working with you as we try to get on with a bipartisan consensus to do something about these trade deficits. Thank you.

The CHAIRMAN. Thank you, Senator Chafee.

Senator WALLOP.

Senator WALLOP. Mr. Chairman, thank you.

Let me add my voice to those welcoming you to the chairmanship. You and I have worked together on a number of things in this committee over the course of time, and it has been a constructive, helpful and useful relationship.

Let me echo that I am now beginning my ninth year on the Finance Committee. This committee has had attendance that has been greater than any committee I have sat on in the Congress. And it has been less partisan, by and large, than any committee that I have sat on in the Congress. And I hope that continues.

With regards to the issue that brings us here and the hearings which you have set forth, I join in congratulating you and thanking you for them.

While I see storm clouds, and I am aware that storm clouds exist, I am not prepared to say the sky is falling. I do not believe that this country is on the verge of imminent collapse. And while Japan is difficult, I think that some of us tend to forget that Europe is today's most restricted market, most protected marketplace among the major trading nations.

And we in this country are not without trade barriers of our own, restricting access to our markets for a variety of things. But let me just suggest that our tax structure is one of the big trade problems. And that which we just accomplished last year is one of the big trade problems. When we increased the cost of capital to American business we refused to come to grips with the 861 R&D, and continue to threaten them with chasing research and development offshore.

Our capital structure is not the best in terms of making people able to compete abroad. But I think what we have failed to do is to enlist perhaps the strongest allay that exists in America for breaking down these restricted market areas to which we would like to go.

Those who stand to lose the most in the United States by restricting our markets are both the consumers, and, as Senator Packwood has pointed out, those who import. They should be picked up as our allies in seeking access to markets overseas. Those who buy from abroad ought to join with us in pressing to open abroad.

To my knowledge, nobody has really made much effort to have them join with us as a government in trying to open these marketplaces. And, goodness sakes, who loses most the quickest? That is those whose livelihood is dependent upon the goods they import from abroad. They are allies for us and I think we can list them on our side.

I think that erecting barriers I have seen in my own state, and others who grow sugar, have seen sugar price itself out of the market for corn sweeteners because we have protected it so much.

I have in many respects seen steel price itself out of automobile component parts where it could be by plastics, not by imports.

Senator Chafee has pointed out that much of what we do to protect ends out eliminating all its effective ability to compete, either domestically or abroad. I am happy to see these hearings come on. There is much to be learned. All of us have much to learn before we set about writing a bill.

Thank you for holding these hearings, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Wallop.

Senator Riegle.

Senator RIEGLE. Thank you, Mr. Chairman.

It is obvious that we are very close to a consensus here, and we can probably have a markup this afternoon based on what I have heard so far.

Let me say how much I appreciate being able to join this committee and to serve under your leadership and to serve with so many distinguished colleagues.

I want to make just two or three brief comments here because I think our trade situation is now so extreme that we not only are suffering enormous current damage, but I think we are putting our whole national future in jeopardy.

I had not planned to bring these charts, but after Senator Baucus enlightened us with his, I thought I would just quickly show you two. And the second one is really as much for your benefit, Ambassador Strauss.

The first one shows the rate of change in our trade deficit with that flat line across the top being a balance of trade. And we can see how, since the mid 1970s, we have been on this downward cascade. This is through 1985. The 1986 numbers, of course, are far worse, the trade deficit is about $173 billion.

If you think of this as the income statement in terms of the trade deficit—what I want to focus on is what I think of as the balance sheet, and that is our underlying financial position as a nation.

This chart demonstrates, that from 1917, we were a creditor nation without interruption, until the last two years when we crossed into this debtor nation status. As others before have mentioned this morning, we are now the number one debtor nation in the world. But I want you to notice the rate of descent, if you will, on a scaled chart. That descent, to me, is a terribly damaging change in national circumstance. We are adding net international debt today at the rate of $1 billion every two and a half days. And the Federal Reserve Board has now estimated that by 1990 we are going to owe the rest of the world a trillion dollars coming from this trade deficit.

Now you can talk about the pros and cons of the trading relationship with any given country, but what I have a hard time understanding is how, if we owe the rest of the world a trillion dollars net by just three years from now, 1990, how we are going to find ourselves in a situation where we can service that debt and hopefully at some point return to solvency? At the same time we have accumulated this massive internal debt, coming off our successive record setting federal deficits over the last several years.

So it seems to me we have to turn these lines around. There is no question about it.

When you get into the guts of the trade problem, it seems to me that Japan is still the number one predatory trading nation in the world today. Their deficit with us last year, despite a 40 percent drop in the value of the dollar, was about $70 billion. And that means they have taken the equivalent of all of those jobs out of this economy, plus the $70 billion scarce capital. And it is true, we get the Japanese cars, and the video recorders, and so forth, but there is not an equal and fair trading relationship.

I am delighted that there are 10,000 workers in Oregon that unload the Japanese cars, but the problem is we ought to have at least another 10 or 20 or 30 thousand workers in Oregon and other states loading American goods on those same ships to go back to Japan. That is not happening because the Japanese will not allow, in area after area, our goods into their country. It is a persistent problem and it is deliberate and conscious. And we are impairing, I think, our financial circumstance and our financial future in ways that put this nation at very serious risk.

Now if it were just Japan, that would be one thing. But we have now got the Japan look-alikes, Taiwan, Hong Kong, Singapore; Taiwan, who is following exactly the same script of using their open access to our market and restricting movement of American goods into their market.

So I hope that we can have a tough trade bill, tough and fair. World trade has to be a 2-way street. It is not today. It isn't a question of blaming one Administration or one party or another. We are all riding this trend line, and we are riding it I think to a future of real peril unless we turn this around. And I hope we will pass legislation this year that will do exactly that.

The CHAIRMAN. Thank you very much, Senator Riegle.

I will now call on Senator Bradley for such comments as he might have.

Senator BRADLEY. Thank you very much, Mr. Chairman. It is a real pleasure to be on the committee under your leadership. And I look forward to working with you and giving you all the assistance I can to try to make sure the committee considers all aspects of every issue that we deal with. It is a pleasure to be here.

It seems to me there is a threshold question when we talk about trade, and the threshold question is: Do we want to resist change or do we want to adapt to change?

The United States has always been a country that was willing to change, and, in fact, sought change as a means of stimulating growth and advancement.

I hope that we will adapt to change as opposed to simply resisting change. That means greater innovation on the one hand, and all the things that go with greater innovation. But it also means being sensitive to those people who are adversely affected by change, because a lot of people are adversely affected by change, whether that is change from imports or change from technology.

So the threshold question is: How do we approach the issue of change?

The next challenge is to make sure we see clearly what are the components of the issue that we have to address.

In 1980, the trade deficit was $36 billion. In 1986, the trade deficit was $175 billion. It would be a shame if the Congress, in a great act of bravado, passed a piece of trade legislation that dealt with trade laws, and it announced that it had solved the trade deficit, only to find out a few years later that the legislation did not result in a dramatic reduction in the trade deficit.

We must look at trade law, without any question. But I have serious doubt as to whether the explosion in the deficit from $36 billion to $175 billion has been largely caused by trade barriers. I suspect that some of it was caused by trade barriers. And I hope we will use our remedies under a multilateral trading system to get at those barriers. But I think we must also be realistic about the price of international transactions, about exchange rates, about demand for international transactions and the effect on that demand of what foreigners owe us, third world debt, and of what we owe foreigners, our external debt.

I think we also have to ask the question, what effect mismatched macroeconomic policies may have. What effect does a stimulative policy in this country combined with a rather sluggish fiscal policy in Germany and Japan have on the trade deficit?

I think we also have to recognize that for the first time in many, many years we have private capital flows, portfolio capital, that makes judgments every minute on the state of the American economy, the world economy, and in fact the political process.

I think we have to consider, and I hope we will consider, the effect of demographics on this issue, because we have a rapidly aging society in Japan and Western Europe that wants to save and a relatively young and vibrant society in the United States that wants to consume.

All of these I think are issues that the committee should explore—exchange rates, debt, mismatched macroeconomic policy, capital flows, demographics—in addition to the very real issue that we all think we will address first, and that we should address, which is trade law itself.

Mr. Chairman, I look forward to these hearings. And I think that you have approached this in your usual thorough way by making sure that we had experts come in and give us what is the real story today. And I am looking forward very much to hearing from Ambassador Strauss.

The **Chairman**. Thank you very much, Senator Bradley.

I would like to now call on Senator Pryor.

Senator **Pryor**. Thank you, Mr. Chairman.

Not a statement but an observation. We have 11 new Democratic Senators in the one hundredth session of the Congress. In requesting their committee assignments, nearly all of these new members of the Senate, chose trade as the first issue that they wanted to be involved with.

I think that really mirrors the intensity of the trade issue. These new members have just been through the political wars. They have talked to every conceivable voter. They have listened to every conceivable group in the past year. And these new Senators I think certainly reflect, Mr. Chairman, the widespread concern over this issue. It is the issue of our time.

I think there are a lot of issues that our people worry about during the daytime. They may be concerned about this or that, the defense budget, or maybe Iran, the Contras, whatever, and those are major issues. But I think the issue that worries them as they go to sleep at night, right before they close their eyes, is will I have a job tomorrow. And that is the reason that this issue is so critical to us, and it is the reason, Mr. Chairman, that we all compliment you for starting these hearings so early and having such a distinguished guest to testify before us today.

The **Chairman**. I thank you very much, Senator Pryor.

I would like to now call on one of our new members of this committee, Senator Daschle.

Senator **Daschle**. Well as Senator Pryor has indicated, I am one of those new members that sought out membership of this committee because of the issue of trade. I commend the committee. I commend the chairman and congratulate him on his ascending to the chairmanship.

I don't think there is a more important issue facing this Congress, facing the Senate, this year than the trade issue. In fact, I believe our international trade posture ought to be viewed as an element of national security. National security is affected by lost jobs. National security is affected by lost business. National security is affected by the importation of food products. National security is affected by our greater dependency on food and fiber, and feed, minerals and metals.

And so with the chronic imbalance in trade which we study this morning, we do so in the context of national strength.

And, frankly, like Senator Bradley, I don't believe that we can address national strength in this regard in a single trade bill. A comprehensive look at competitive trade positions in international commerce is essential. The structure of government bureaucracy charged to trade-making policy, the relative value of the dollar, major foreign impediments, like the recent so-called third country initiative in Europe, the partnership, or lack of it, between business and government, our determination to promote and market abroad, with all of these components in mind, I know that, as the newest member, and the most junior member of all of us on this committee, I have a great deal to learn about how we come to the position in which we find ourselves today, about how we resolve this threat to national security, about how we write law to address this matter, not for just the coming year but the coming generation.

This hearing is an invaluable beginning, and I look forward to discussing the matter with our able witness, Bob Strauss.

On a personal note, let me just say that I am honored to be a member of this committee and I look forward to working with each member. Thank yov, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Senator Matsunaga.

Senator MATSUNAGA. Thank you, Mr. Chairman.

I will forego my opening statement, except to say that I am happy to see my good friend from Texas being elevated to the chairmanship of this committee, and that he has recognized the seriousness to the point of making trade policy the number one issue and holding early hearings here. I congratulate him for it.

I think the Constitution of the United States grants the Congress the sole power to regulate commerce with foreign countries, as well as the authority to set and lay and collect duties. But we have abandoned this responsibility. And I hope that under your leadership, Mr. Chairman, we will resume that responsibility and get away from what many of our trading partners today are fearful of, that is, a policy of protectionism, and establish a policy of mutuality, one of reciprosity. And with that, Mr. Chairman, I thank you.

The CHAIRMAN. Thank you very much, Senator Matsunaga. And I see Senator Danforth has returned. Senator Danforth and I have worked together on a great deal of trade legislation last year and I would like to recognize him.

Senator DANFORTH. Mr. Chairman, thank you very much.

We have indeed worked together on trade legislation beginning, as I recall, with the 1979 trade bill that was the legislation that implemented the Tokyo Round, when Ambassador Strauss did such a masterful job of negotiating that agreement and getting it through Congress.

I am delighted, Mr. Chairman, that you have begun the new year with hearings on trade. Clearly, the great, really buzz word, that is being used now is competitiveness. All of us are concerned about it. All of us are concerned about a huge trade deficit, way beyond any expectation just a few years ago. We want to do something about it.

I have no doubt that we will pass a trade bill this year. Whether it is a good bill or a bad bill remains to be seen. Whether it is a bill which the President will sign or which the President will veto remains to be seen.

I would hope that we would act responsibly. I would hope that we would pass tough trade legislation, legislation which would improve our ability to enforce international agreements; to provide for fair trade; to provide for a concept of reciprosity. But I would hope that we would avoid the temptation to tip over into full blown protectionism, which has not worked well in the past in this country, and which obviously, if Congress did pass a truly protectionist bill, would be nothing more than veto bait for the President.

I think it is important to see trade legislation in context. Competitiveness has indeed become the great buzz word, but most knowledgeable people would tell us that trade legislation, per se, retraining legislation, per se, deals with only the edges of the very serious problem in the United States.

It is not possible to correct fundamental problems with tangential approaches. The fundamental dealing with the trade deficit has to do with the larger economic questions of the federal budget and of tax policy.

I am not an economist, but every economist that I have spoken with for a long time has told me that the trade deficit is a direct function of the deficit in the federal budget, and, therefore, the battle of the budget must be fought and it must be fought effectively. And that has been the most difficult battle that we have had in the Congress.

With respect to tax legislation, I am not going to repeat my fist-pounding speeches of the past. I do think that the tax bill that we passed last year is one that went in the wrong direction. It encouraged consumption and it paid for increased consumption by increasing the cost of capital most economists say by about 10 percent. We have reduced the research and development task credit and sunsetted it, thereby damaging what had been—blunting what had been the cutting edge that the United States did have in international competition.

We increased substantially the tax on Americans doing business abroad. They account for something like 40 percent of the market for U.S. goods that are sold abroad.

I would like myself to open up some of those questions, but I am reasonable sure that that is not going to happen, at least for the next couple of years. But I would point out that I think that it is important as we address the great hot issue of competitiveness that the fundamental questions remain, and they have to do with the budget and they have to do with tax policy.

And thank you very much, Mr. Chairman, for holding these hearings.

The **CHAIRMAN**. Thank you, Senator Danforth.

Senator Mitchell.

Senator **MITCHELL**. Last year marked the fifth year in a row in which the United States trade deficit reached a record level. The last month for which statistics are available, November 1986, showed a record monthly trade deficit of over $19 billion. And that one month alone this nation ran a trade deficit that exceeded the entire annual deficit just a decade ago.

When the totals are calculated for 1986 they will likely show a trade deficit of over $170 billion. Perhaps the most startling figure illustrating our present difficulty is that in 1986 the total value of United States exports, even in nominal dollars, will be less than the value exported in 1980. That will mark the fourth year in a row in which the value of United States exports has been less than exported in 1980.

For the latest year in which figures are available, United States imports of manufactured goods exceeded manufactured exports by almost 66 percent. Deficits of that magnitude can do nothing other than undermin this nation's welfare, reducing economic growth at a cost of millions of American jobs, and ultimately ensuring a lower standard of living for Americans.

In industry after industry, imports are claiming a larger share of the domestic market, while our export industries continue to lose market share abroad.

If we are to effectively deal with this problem we must realize that there are many causes of our trade difficulty. We must, of course, as virtually every Senator has suggested, divise policies to improve the competitive position of American industry. But it means we must also change the policies which have permitted enormous federal budget deficits today at a cost of a lower standard of living tomorrow.

We can pass all the trade laws that have been proposed aimed at increasing exports or limiting imports, and we will still not have addressed one of the fundamental causes of our problem, which is continued large budget deficits.

It is appropriate that this committee which has jurisdiction over a large part of the federal budget, including revenue, is also charged with the primary responsibility of governing international trade issues. It is my hope that this committee will exercise leadership in both areas to fashion a meaningful response to a very serious trade problem.

Mr. Chairman, I look forward to working with you and the other members of this committee. And when he gets around to talking, I look forward to hearing from our witness today.

The CHAIRMAN. Thank you, Senator Mitchell.

Senator Roth.

Senator ROTH. Mr. Chairman, I will echo that last comment. I am anxious to hear my good friend, Mr. Strauss, who has done such a bang up job for this country in the past. I do find it, Mr. Chairman, a little strange to be here to the left of the majority.

The CHAIRMAN. Mr. Ambassador, I had encouraged each of these members to make an opening statement, which we normally don't do, at the beginning of these hearings to demonstrate the depth of their feeling and their concern about this major issue, which has moved us from being the number one creditor nation in the world to the number one debtor nation in the world in just three years.

We are fortunate that the Japanese are coming in and buying our securities at a time like this, but we also have to understand that they do not have a Marshall plan in mind, and those securities have to be paid back.

And that means we have to turn this deficit around. We know it is not just the fault of other nations, and we know it is not just caused by protectionist barriers around the world. Some of it is, of course. But we know there are things we have to do ourselves to become more competitive.

We have seen world trade expand through the 1970s and the entire world profit by it. And then in the 1980s we have seen it go flat. And much of the world has suffered by it.

We have seen third world countries have an extremely difficult time meeting their debts, a tough time selling their products. We have seen this country buy 57 percent of the manufactured products from third world countries. The Europeans buy 27 percent and the Japanese buy 9 percent.

If we could get the rest of the world to buy those manufactured products on the same per capita basis as we do, we would see an expansion of world trade by over $250 billion and the whole world would profit by it. Those are the kinds of things we are seeking in this piece of legislation.

Mr. Ambassador, I know of no man who has served in the Executive branch who has been more effective in working with this Congress in a bipartisan way, with Republicans and Democrats, in trying to develop a consensus. You have understood the importance of increasing world trade. And, therefore, we are very pleased to have you as our first witness.

Mr. Ambassador, if you would proceed.

STATEMENT OF MR. ROBERT STRAUSS, AKIN, GUMP, STRAUSS, HAUER & FELD, WASHINGTON, DC

Mr. STRAUSS. Thank you very much, Senator Bentsen, and members of the committee.

First, let me say that I appreciate your remarks very much. As I have said to you before and you have heard me say on other occasions, I am vain and silly enough to enjoy hearing things like that and sensible enough not to pay too much attention to them, I hope.

As a matter of fact, Mr. Chairman, it was 10 years ago that I appeared before this committee with very little experience in the trade field, to be confirmed as Special Trade Representative and it was a proud moment for me. And I am equally proud, let me say, to be invited back today as the lead-off witness to talk about the problems our country faces in international trade and the problems of the world economy in general.

This morning I would like to renew and strengthen, if I may, a disclaimer I made on that prior occasion: after 10 years of rather broad experience, I still have no simple over-the-counter remedies to our various economic ailments. However, I do have some ideas and some suggestions to share with you, and I hope they will help put the subject of trade policy in some perspective.

First, let me say at the outset very clearly, I do believe we need a new trade policy for the United States and, accordingly, I strongly endorse the initiative by this committee.

Many that you will hear from know more about the certain specific, substantive issues that you will consider than I. My special expertise, as many of you know, if I have one, is in the field of political process. If our political process can be made to function effectively between Congress and the Executive branch, between the political parties and between the government and the private sector, then we will more successfully grapple with the problems we are encountering in international trade and with the forces that are eroding our competitive position in the world economy.

Tough choices must be made by you, compromises struck, and bitter medicine swallowed. And above all, the Congress and the Executive branch must work together to devise a common program and then speak with a common voice. A political consensus must be formed in this nation to support your efforts and your eventual work product, or it cannot be implemented and certainly cannot be sustained.

Your remarks, Mr. Chairman, and those of Senator Packwood, and others of your colleagues, on your desire for a bipartisan Congressional effort are positive and very encouraging. So is the indication from Secretary Baker that the Administration wants to be a cooperative player. Furthermore, the Administration is to be commended on its efforts to launch the Uruguay Round. But multilateral negotiations alone cannot solve our trade problems.

I am aware that some are skeptical about the necessity or the desirability even of passing trade legislation in 1987. Some believe that the President already possesses all the legal authority he requires. Others are properly concerned about protectionism.

These skeptics, in my opinion, do not fully appreciate the American political process. For it is in the process of devising legislation that the Congress and the Executive branch, in consultation with the private sector, will find and articulate a coherent trade policy for this country. The process of legislating will focus attention on trade and impose a time-frame in which a consensus must be reached.

It is critical—critical—that this committee objectively and unemotionally, putting aside individual, narrow, parochial interests, define the problems we face, examine the root causes of those problems, and stake out a course for what we have to do to begin to solve them.

While attacking trade barriers and unfair trading practices is vital, the committee most not forget that the principal culprits are an economic policy that has produced unbelievable budget deficits, a dollar out of balance with other currencies, soaring consumer debt, and productivity and competitiveness reaching new lows.

In order to think clearly and constructively about issues such as this, I find it helpful to keep certain core concepts in mind and to distinguish one from the other.

First, there are trade policy problems which afflict producers and consumers in the United States and other countries and which are rapidly eroding the international trading system. Examples abound in the field of agriculture, telecommunications, intellectual property rights and elsewhere.

We must attack these problems aggressively because they adversely affect producer interests in our country and, in turn, our overall economic welfare. But we should not delude ourselves into believing that these trade policy problems are the sole or even major cause of our trade deficit or that they are the major drag on our economy because they are not.

Separate and apart from these trade policy problems, there are economic problems facing our nation and the world which demand attention. It is these economic problems which also greatly impact the trade performance of our country. These economic problems were created largely by macroeconomic policies which must be dealt with. There are no quick fixes for these problems. It took years and years of bad economic policies to create them and it will require considerable time to undo them.

Let me give you some examples.

The European Economic Community still maintains a monument to protectionist folly known as the Common Agricultural Policy, CAP. The CAP costs approximately $27 billion a year to maintain, and part of the waste is borne by European taxpayers and consumers, but a large part of that cost is shifted onto agricultural producers in other countries, most significantly in the midwestern United States.

This is the preeminent example of a trade policy problem which must be eliminated through negotiation. Our domestic agricultural problems, which cause so many hardships and eat up tremendous sums of taxpayers' money, can really only be solved in an international context.

Another example of a trade policy problem can be found in the field of telecommunications. The United States has unilaterally opened its telecommunications markets to imports from other countries without demanding that other countries similarly open their closed telecommunications markets to our exports as well. This, too, is a trade policy problem that cries out for immediate attention.

As serious as these and many other trade policy problems are, and they are deadly serious, they should not divert our attention from other serious problems which are impairing our competitive position and weakening the world economy.

It is easy—often too easy—to blame all our trade problems on the foreigners. All nations do that. Foreigners don't vote. But it is now time to begin asking ourselves some tough questions about the performance of our own U.S. economy. Why is it, for example, that U.S. productivity, as we have talked about today, lags far behind those of our principal competitors and has done so for many years?

In the 1960s, our competitiveness grew at a rate that doubled our standard of living every 23 years, doubled every 23 years. At today's rate of growth, it will require 70 years.

Why is it that in the U.S., expenditures for research and development, investment in new plant and equipment, and other critical signs of economic vitality are lagging compared with other countries? What are we going to do about our budget deficits? Why aren't we at least leveling with the American people about the implications and attempting to get their political support to build a political consensus to enable us to properly address these problems?

We cannot begin to address our nation's trade problems in a meaningful way unless we begin to come up with some answers to these and other troubling questions that will be before you as you continue your deliberations. At the same time we must direct our attention to the serious problems of the global economy, including specifically third world debt, global problems that are preventing these economies from growing and importing our products.

We must also examine the reasons for slow growth in industrial nations. After World War II, we spent our resources supporting others. Now, the capital exporting countries should be directly called upon to increase their assistance to the third world. Without dwelling further on specifics, leaders in both government and the private sector must come to appreciate more fully the rapid internationalization of markets and the consequences of this for national policy and for private business decisions.

As I conclude my opening statement, I hope it is not presumptuous to draw some lessons I have learned from my experience in the public and private sectors.

Number one: Partisan trade policy is bad trade policy. I have talked of forging a political consensus. As STR, many of you will remember, I worked particularly closely with then chairman Long, and Senator Ribicoff, and with you, Mr. Chairman, and many others on your side, Senator Bradley, Senator Matsunaga, but I can never forget how important the strong support of Senators Dole, and Roth, Jack Danforth and John Heinz, and others on the Republican side was to our efforts. It was bipartisan support that was essential, absolutely essential, to the drafting and then the passage of the 1979 Trade Act almost unanimously in the House and Senate. And you will all remember when we began, everyone said it couldn't be done.

Number two: The Executive branch must speak with one voice on trade policy. We need a trade policy for America, not a policy for Treasury, Commerce, State, STR or Defense. Trade problems must receive the personal attention of the President and his White House advisors. And I cannot emphasize this point enough. No foreign nation will take our trade negotiations and policies seriously unless they believe that the President is personally involved in the process. Ministers can only nibble around the edges of the problems.

Number three: Neither the Congress nor the Executive branch can make good trade policy on their own. They must, as I said earlier, work together.

Number four: Trade policy cannot be separated from domestic economic policy, as we pointed out. The greatest single problem behind our trade deficit is our budget deficit. An overvalued dollar has priced us out of key markets and has made imports appealing to our consumers.

Number five: The search for new ideas in the trade policy area is not a substitute for effective action. Over the past few years, members of Congress, business leaders, think tanks of all political persuasions, and academics have been working to explain our trade problem and develop new solutions, new ideas. However, the search for new ideas, while worthwhile, has become an end in itself.

We must no longer postpone action. We must reduce the deficit, deal with the third world debt in a sensible fashion, crack down on unfair trade practices, and coordinate trade policy within the Executive branch, possibly with a new Department of Trade.

I have long opposed a new trade department, as have many of you, but maybe it is an idea whose time has come. At any rate, it should be examined and accepted or rejected for the right reasons, not to satisfy narrow bureaucratic interests, which has been the case in the past. It is not a substitute for substantive action, but if done in a proper way, could possibly help us develop and execute better trade policy. And I frankly do not know what the proper way is.

Number six: Government cannot develop effective trade policies in isolation. Business, agriculture and labor must be deeply involved in the policy process.

In 1974, this committee established a private sector advisory system to ensure that private sector input was fully considered in formulating trade policy. This system, in my opinion and that of may others on both sides of the aisle, has recently been neglected and should be restored.

Number seven: Trade today, as when the nation was founded, is a commercial process based on reciprocal treatment. It must be fair or it cannot work.

We have exercised world leadership by keeping our markets open and our investment climate unrestricted. Other nations have not always reciprocated. Now the message should go forth from your deliberations that those who wish to sell their goods and offer their services in our markets must extend similar treatment to us. To say it a bit more dramatically, those whose ships loaded with products enter our harbors must make room for our ships in theirs.

And, finally, Mr. Chairman, there is the question of Japan.

The United States cannot deal with its trade problems without confronting the issues posed by our $54.6 billion trade deficit with that country. There is no one solution to the complex set of economic and cultural factors that have created this massive bilateral trade deficit. However, we are mired in a sector by sector approach that has produced meager results.

The time has now come to elevate this issue to the highest political level. We should convene a fully prepared, U.S.-Japan economic summit; not a series of photo opportunities but a real negotiation where both parties attend, fully prepared to put meaningful bargaining chips on the table in an effort to achieve substantive results. This summit should take place within the next six months and be structured with ample opportunity for Congressional participation.

Mr. Chairman, the issues before you and the members of this committee are immense in their implications. Freedom around the world depends on the strength of the United States and our strength depends on our maintaining a strong and balanced economy.

It is my firm conviction that if we raise U.S. trade policy to the same status as defense policy, and if we form a political consensus on trade, we can, within five years, reach new economic horizons for America that will enrich the economic lives of our citizens and make the world a safer place to live. With the greatest of sincerity and without hyperbole, I say to you that you, the members of this committee, that you can lead this nation in an historic step forward.

Thank you, Mr. Chairman.

The **Chairman**. Mr. Ambassador, that lived up to my hopes and my expectations, and you have helped set a basis I think for productive hearings.

You listened to the diversity of opinion on this committee. They were sincere statements and you know where they are coming from. I think we can work out a bipartisan bill that will meet most of the objectives of the members of this committee, and, in that democratic process, finally develop a consensus.

I noted that as you worked on the Tokyo Round, and with your remarkable success in it, we had a great exchange of information between you, the Executive branch, and the Congress.

It seemed to me that the 1974 Trade Act required that kind of exchange, such as cable traffic information, such as continuing consultation with the Congress, such as having members of the Congress as members of the trade delegation. It seemed to me that the exchange was helpful in trying to achieve a consensus. Would you comment on that?

Mr. STRAUSS. Mr. Chairman, I think the term "helpful" is a gross understatement. It was almost essential. And I look at the members of this committee. I see Senator Roth there who will tell you that a week hardly passed that we didn't talk or I didn't meet with him. I remember Senator Ribicoff, who chaired the subcommittee, was deeply involved in working with him. And I think that the guidance I received from the Hill, this committee, the Ways and Means Committee, my ability to articulate problems to them, or their ability to understand—I mean the larger context instead of the narrow parochial interests—enabled us to work together and it worked exceedingly well.

The CHAIRMAN. Well, Mr. Ambassador, we had some differences with the Administration last year, the Republicans and Democrats on this committee, about bringing forth a trade bill. I think that led to a feeling by some members that we should no longer continue the fast-track for trade legislation. I would like to hear your comments about the necessity for fast-track legislation.

Mr. STRAUSS. Mr. Chairman, you cannot expect your negotiators to be able to successfully negotiate trade agreements without a fast-track, in my judgment. Now I know there is a point of view that thinks the Administration should be called upon to sort of lay out their goals and their objectives first, and possibly then lay out broad objectives, but I must say to you that if we don't have fast-track legislation, you, in my judgment, will not have a meaningful negotiation. It would have no credibility with the Europeans or the Japanese that it could get through this Congress.

The CHAIRMAN. Mr. Ambassador, I share that viewpoint with you. But some of us feel that we do not have a full understanding of the objectives of the Administration on these trade negotiations.

Now if we are to give them fast-track authority for those negotiations, then shouldn't the Administration be willing to make a statement of trade policy to us that is acceptable to us and approved by the Congress before we surrender our constitutional rights by providing the Administration with fast-track?

Mr. STRAUSS. I don't think there is any question, Mr. Chairman, that the committee not only has the right to expect it, it should almost require it.

One of the members of the committee said there is plenty of blame to go around, and there is. I think one of the great defaults we have had though in the trade area was the failure of the Administration to more effectively use Bill Brock, a former member of the Senate, in his capacity as STR. I don't think he had the kind of support that was necessary. I don't think he had the kind of commitment that enabled him to make the kind of statements and representations that he would have wanted to make.

I don't know of anyone who couldn't be more competent in that job or anyone who developed more credibility, if you will, with our foreign trading partners, and would have been not only able to make the kind of representations to the Congress that it wanted to hear, but who could have made the kind of representations that were needed to be abroad. But he did not have the kind of support or backup he needed.

The **Chairman**. The authority for the negotiations expire, as I recall, in January of 1988. The last time the authorization was given for a period of five years. How long do you think we ought to give the Administration this time?

Mr. **Strauss**. Well, I think five years is a reasonable period of time. It would be extended by, as I recall, a majority vote, and it can be extended. And I think we need a time frame, and I think we need to put some time pressures and I would think five years would be a reasonable time.

The **Chairman**. Let me ask you a two-part question.

Mr. **Strauss**. Certainly no more.

The **Chairman**. As you know, Senator Danforth and I co-sponsored the telecommunications trade legislation which the Finance Committee reported out last year, and in your testimony you referred to the problem on telecommunications. Our colleagues in the House proposed similar legislation. I would like to ask you whether or not you think that legislation is still necessary, and whether or not the negotiation procedures that were envisioned in that bill are the most appropriate way to accomplish the objectives of that legislation?

Mr. **Strauss**. My recollection is that that legislation talked about a period of time to define problems and a period of time to work on them, and then a time with mandatory retaliation sort of impacted. That is my general recollection.

I personally believe that we need, and we can use, a sectoral negotiation on telecommunications with a number of countries. I think that unquestionably when we opened our markets, deregulated, and did not require other countries to do the same we ran the risk of losing the advantage of being on the leading cutting edge of technology.

The **Chairman**. Do you know, Mr. Ambassador, they talk about many areas where they say we are just not competitive or we don't have the quality of product. But that is not true in telecommunications.

Mr. **Strauss**. Correct.

The **Chairman**. We are on the cutting edge of technology there. And when we deregulated and said to AT&T buy from whomever you want, foreign companies came in and they have done very well. And we welcomed them in. But we have not been that kind of opening of the market in some of these other countries. I look at Germany and the Bundepost and what they are buying, 2 and 3 billion dollars worth of telecommunications gear, but only a pittance for our product.

Mr. **Strauss**. Yes. Our basic problem in getting at that has been this, Mr. Chairman. Most of the communications systems in other nations are government-controlled, or quasi-government-controlled, and in our government procurement program, we are not able to get at it properly. And those who would sell this country their products do not give us that same opportunity.

I heard an interesting story—maybe it is impossible. I don't think it is; I think it is true—that someone said that—I guess, first, I ought to make one statement.

I, as a lawyer, do some work for AT&T, and I don't want to be up here with false colors. This is an area in which I have some personal interest in and I would like to make that statement in that regard. Someone lackingly said to me that President Reagan and Prime Minister Maroney should be able to speak together very well because they both speak on northern telecoms, a Canadian company system. And when I said, well, maybe they bid a better product or bid more successfully, the answer was, maybe they did, but the difference is they had an opportunity to bid on the U.S. job. And in Canada, we don't have an opportunity to bid on their job. So we will never know.

Now telecommunications, for example—take Canada, the country we are talking about—we are entering into bilateral negotiations for a new trade treaty with Canada, as you know and are particularly familiar with since you have recently been up there, as I say in the press. Canada is extremely competitive with the United States in this area, probably as competitive as any nation in the world, and yet it doesn't flow both ways. The tariffs are altogether different. Opportunities for bidding are altogether different. It just does not work both ways.

The CHAIRMAN. Mr. Ambassador, I am sure my time has expired. And I would like now to turn the questions over to Senator Heinz. And let's move it up from five minutes to seven minutes, looking at the numbers we have here. Hopefully, we can follow that program. Senator Heinz.

Senator HEINZ. Mr. Chairman, thank you.

Mr. Ambassador, it is good to see you. I, too, recall the excellent job you did in working with the members of the Finance Committee and just about everybody else in the United States in fashioning the 1979 Trade Act. I don't know of anybody who, when it comes to producing results, has a better track record than you, which is probably why Bob Dole, in remarks at the National Press Club one night, as a compliment, said of you, he is the only person he knew who, if you came in on a swinging door behind him, would enter ahead into the next room. [Laughter.]

Mr. STRAUSS. I remember that questionable comment, Senator.

Senator HEINZ. I took it as a compliment.

I think we have learned a lot since 1979. I think we are a little more aware of some of the practices that are taking place. And it was interesting to me that six or seven years ago you would not have had, as we have heard today, members of this committee and its witnesses signalling out a specific country by name, not only time and again, but almost with unanimity. I refer to the signalling out of Japan in just about everybody's statements, for obvious reasons.

It, however, would be a mistake if in our enlightenment about the mercantilist Japanese trading system we ignored the fact that there are other trading systems—Korea and Taiwan come to mind—that are equally mercantilist and deserving of our attention.

It has been said by some, particularly economists, that if we were successful in getting these economies to abandon their protectionist policies that it would not really help our trade deficit all that much, at least in the near term, which is, for a Senator, six years maximum. And that is probably right. But the problems that we feel and you have identified are problems that have been 20 or 30 years in the making, and the solutions are probably going to be 10 or 15 or 20 years—maybe that is optimistic—in having the desired and beneficial results. So that if we open up the Japanese market, not just to us but to competition from everyone, it may be a while before we feel the results of that and the benefits of it.

In your statement, you suggest that the way to approach a protectionist country like Japan—and you singled them out—is to have a meeting with them that is properly prepared, and for both sides to put their bargaining chips on the table.

We have the world's most open economy, although we are by no means purists. We have some protections on the books, but we have still the most open economy, and Japan has just about the opposite.

My question to you is what are our bargaining chips?

Mr. STRAUSS. Well, Senator, let me kind of back into that and say to you that in my judgment and in the judgment of the people whose judgment I value, we really do have a very special relationship and a very important relationship with Japan, and they with us. We are the two world's greatest economies, and we have other big stakes in the Pacific defense and otherwise with Japan. And one of the reasons I would call for the kind of summit that I call for is because our relationship with Japan will continue to deteriorate unless we really come to grips with the problems that exist between us, just as two individuals must sit down and resolve. If they have a difference of opinion or a misunderstanding, they have got to get together and hammer out some of the truth in that relationship. And I think the tougher we hammer out the truths of the relationship between Japan and the United States, the better our relationship will end up being for our common good, the Japanese as well as ourselves.

Now one of the things I think, one of the chips we have is to put on the table if we struck a global bargain with them, is the fact that while all their procurement policies must go on the table, and they must agree to do something about it, or a great many of them, most of them, we must put on the table our willingness to come to grips with this skewed economic policy we have in this country that is sappening off the capital of the world. And nothing that we can do have more appeal to the Japanese, the Europeans, other nations in the world than if we said to them, we are going to do something about the economic policies in this country that are soaking up all of your capital, and bringing it into our country rather than letting it be invested in your own. That is the biggest bargaining chip of them all, do something about our deficits.

Let me say to you also, it is a very interesting thing you are talking about the problems of the Japanese. It is interesting. I saw a story and it confirmed what I had heard from others. And I go to Japan occasionally. I saw an NAC over there that was farming out a great deal of their manufacturing to Taiwan, to Korea, and other places because they are finding cheaper and skilled labor there. Now you are finding the Japanese are beginning to farm out themselves to other smaller nations in that area.

Senator HEINZ. Bob, let me ask you this. I think I may have a minute or so left. If our experience with the Japanese in the sectoral talks to which you referred has been very slow, and even if after an agreement is reached, if is pretty tough to collect on, why should we be optimistic that in a much broader, much more wide ranging, much tougher bargaining situation, assuming that your position on leverage and bargaining chips is a powerful one, we would be likely to succeed, and, most importantly, likely to achieve the follow through that so often seems to be pretty hard to get?

Mr. STRAUSS. Well, I guess I am an optimist by nature, and I certainly do not think it will be easy, nor do I think we will reach optimum results. But I think there is great progress that still can be made. It is tough; it is hard. The Japanese are very difficult to negotiate with, and, as you say, even more difficult to implement policies with, even though they try.

I give the Japanese credit in many areas. They are trying very hard and they cannot breech their own cultural problems in their own nation. So I don't think it is going to be easy. I don't think it is going to be fast. But they say things have to get worse before they get better. They have gotten worse.

Senator HEINZ. They sure have.

Mr. STRAUSS. Maybe it is time we try to make them a bit better.

Senator HEINZ. My time has expired.

The CHAIRMAN. Senator Packwood.

Senator PACKWOOD. Mr. Ambassador, on communications you talked about sectoral bargaining. Do you want to follow that policy in all sectors or are you zeroing in on communications?

Mr. STRAUSS. We were talking about communications at that time. I am a proponent of the U.S.-Canadian talks that are going forward now, bilateral talks. I think that they are going to be tough, but I think they are worthwhile exploring, as the Administration is doing. The problem we have there is that those negotiations are the biggest political item in Canada and here nobody knows anything about them. They are unknown here. They are on the back burner.

Senator PACKWOOD. But as a conclusion, you think we should not necessarily bargain jobs sectorally?

Mr. STRAUSS. Oh, no.

Senator PACKWOOD. All right.

My second question. During the Carter Administration there was no 301 retaliation, although President Reagan has tried six with some degree of success. Do you think any trade that we have should require mandatory retaliation?

Mr. STRAUSS. Well, I am a little hesitant to require mandatory retaliation, Senator Packwood. I think 301 could have been used more effectively than it has been used. I do not think it has been used well. It has had some modest success. Again going back, I think they could have done better in that area. On the other hand, I hate to make it mandatory. I think somewhere in between. There are stopping places in between mandatory in where we are now, where we could tighten it up, and I think would improve some changes.

A lot of it depends upon the attitude of the man who sits in the White House. Some feel one way and some another. Who knows who's right and who's wrong? But they would use thet power in different ways. And I guess it would have been—I guess, more mandatory is a bum choice of words——

Senator Packwood. But not compulsory.

Mr. Strauss. But not totally inaccurate. Let me say that.

Senator Packwood. Now my third question. Assuming you do not make it compulsory, and you have the political heads of Japan and the United States, and maybe other countries, sit down, should our President have only economic goals in mind or can he trade off some economic goals for non-economic objectives, political objectives, military objectives?

Mr. Strauss. I don't think there is any question that they can, Senator. And I think that that is a responsibility of the President. I might not like it at the time, but a President has the broadest interest of this nation involved. But at this particular point in time, it is hard to find any of those broader implications that are more important than the trade and economic ones. At another time he might find it another way.

Senator Packwood. Now, my last question. I agree. And I also agree with you that if we make it compulsory—and it has got to be automobiles for automobiles or coal for coal—not only can he not bargain on anything else, but maybe he ought to be bargaining on coal versus automobiles. And you are not going to allow it.

Mr. Strauss. That is correct.

Let me say this, that the thing I don't like is that whenever a President starts to get tough in a negotiation, or use the 301, is that other branches of the government come and lean on him with things that are second- and third-rate issues to stop him from doing something, instead of a broader and more significant interest.

Senator Packwood. My last question, Mr. Ambassador. On page 5 of your statement you say, "Now the message should go forth from your deliberations, that those who wish to sell their goods and offer their services in our markets must extend similar treatment."

We had an interesting situation last year on the new textile agreement in which we enforced quotas on Hong Kong, although they have no restrictions to their market. Is that fair? They indeed will let us sell automobiles or textiles or watches or cameras or anything else without barriers. Should they, therefore, have reciprocity in this market?

Mr. Strauss. Well, let me answer this another way. It is easy to let someone have total access to your market if you know they cannot compete in that market. And the reason there is no reason for any barriers is that you could serve it up on a silver tray and you cannot sell those items in that market.

Senator Packwood. Well, then what are you saying?

Mr. Strauss. Well, I am saying to you is just because there are no barriers there is not a reason for us to ignore the implications of what an open textile policy vis-a-vis Hong Kong might mean to the textile industry in this country and the textile workers in this country.

Senator Packwood. All right. Now I see where you are coming from.

What you are saying, therefore, is even if Japan opens up and lets us into the automobile market, I don't think we are going to sell very many cars in Japan. I think we could sell a lot of telecommunications. So your standard is not just are they an open market; do they let us have access. You were saying there are still factors where we should impose quotas or restrictions or limitations on imports even if the other country is not at fault at all and we have access to a market.

Mr. **Strauss**. I would say you have to be exceedingly pragmatic, yes, Senator.

For example, the opening up of automobile markets and the keeping of agricultural markets as close as they are in Japan would not send me into great ecstasy because I know damned well we are not going to sell any automobiles nor are we going to export any more agriculture to them.

Senator **Packwood**. I think we could do pretty well on agriculture in some areas, where they simply are not competitive with it. They would not be competitive in rice today if we could get into their market.

Mr. **Strauss**. That is correct.

Senator **Packwood**. Automobiles I am inclined to agree with you. There is a fair number of areas where we could be competitive.

Mr. **Strauss**. No question about it.

Senator **Packwood**. Thank you, Mr. Chairman.

The **Chairman**. Thank you very much, Senator Packwood.

Senator Rockefeller, please proceed.

Senator **Rockefeller**. Thank you, Mr. Chairman.

Mr. Ambassador, there are fewer optimists about the trade situation than there were a few years ago, and I think one of the reasons for that is this whole question of high technology.

There is a theory that this country was inevitably going to suffer one way or another with respect to textiles, steel, machinery, and other products because of a variety of ways in which those could be produced more efficiently, more cheaply, at a high quality in other countries. That was discomforting, and it was particularly discomforting to somebody from a state like West Virginia where all of those things were involved.

But we did not suspect that there was going to be any problem in our lead in information and computer technology and telecommunications, the whole high tech sector.

Now that seems to have changed. Some have said in the past, that we would give up to some extent on automobiles or on steel, but that we would be preeminent in high technology and would always be at the cutting edge. That has not been true.

Mr. **Strauss**. No, Senator. As a matter of fact you can add in there a big item we need to get to and that is in the area of services, again, where we are preeminent. And those are the kind of areas where we can insist upon our rights.

Senator **Rockefeller**. I would agree. But now with the new industrialized countries and others such as Brazil protecting their high technology sectors as a matter of national pride and a matter of economic pursuit, you cannot blame them for that.

Mr. **Strauss**. No.

Senator **Rockefeller**. And that is something they are doing. It is not what we expected. It has changed the international rules. How can we react to this? If we go from the traditional fear that we may see a decline in, or lose some of, our basic industry, perhaps protecting or keeping some of those which have to do directly with national security, such as steel, is appropriate. Now we see technological innovations being duplicated by many others very quickly, very rapidly. We make the invention; they duplicate. Or they make the invention; they produce. How can we adjust trade policy under this new set of rules?

Mr. **Strauss**. Well, Senator, I don't know the answer to that, of course. You mentioned the areas that a good many of them fall in the area of government procurement. And we really have not made any progress in government procurement, where these countries who control their communication system, government-owned or, as I said earlier, quasi-government-owned, refuse to permit us to do business with them, to bid fairly.

Some have carrots. Some have buy whatever country, buy Brazil, buy Canada, buy this restriction. And I think just in our overall negotiations, and hopefully in the Uruguay Round those are the kind of things that are going to be dealt with. And that is what your trade negotiators are hired to do and that is what they set out to do. And that is why they need Presidential leadership, this Administration and the one that will succeed it. The President should be on the cutting edge of those negotiations demanding certain things take place. And that is the give and take of a Uruguay Round, if you will.

Senator **Rockefeller**. Do you think that even with strong Presidential attention the position of the U.S. Trade Representative has sufficient structural institutional clout from one President to another under the present circumstances to be effective? Or do you not believe so? Are you inclined, for the first time, toward considering a Department of Trade or some other mechanism to raise trade policy to a higher structural level in our government?

Mr. **Strauss**. Well, without trying to be partisan, a Democrat, in my remarks, I would lead into them by saying while there are many things this Administration can take great pride in, I don't think they can take great pride in trade policy, the creation or the execution of it. And I think they are lacking there. And I don't think a trade representative representing a passive Administration, a passive White House, has a chance. Whereas, a trade representative, the people talked about President Carter being ineffective in many areas, and possibly lacking leadership in certain areas. In the field of trade, he was simply outstanding, Senator Rockefeller.

I could go into his office and say, Mr. President, you need to call Helmut Schmidt today and you need to tell him one, two, three. And he would pick up the phone and make that call. Or to Callahan, in Great Britain. And when I put a memorandum in his briefcase, and said when you hit Brussels here is what you have to say to these people. He would do that. And meticulously, one, two, three, four. That was his strength. Some say that same thing has his weakness.

Let me make one more point. In the negotiations, as Senator Roth and others know, when we had summit meetings the STR sat in that summit meeting, next to the President, and negotiated with deals of government, with the support of the President of the

United States. That is a big advantage over what Clayton Yeutter has right now and what Bill Brock had before him.

Now in other areas—I am not trying partisan political remarks; you can say well in the areas of Defense, or something—it was different. We are talking about trade; that is what I know about. If you want to talk about these other issues, get yourself another boy. [Laughter.]

Senator ROCKEFELLER. Mr. Ambassador, you wrote an article four years ago in the Wall Street Journal in which you pointed out that the American farmer really isn't competing against the European farmer. He is competing against the European government. And you carried that analogy through to the American aerospace worker competing against France's public policy and the American computer technician——

Mr. STRAUSS. Senator, could I interrupt and say I sure hate a fellow bringing up anything I wrote four years ago. But go ahead. [Laughter.]

Senator ROCKEFELLER. You went on to make an interesting statement because you said that, obviously, real economic recovery in America and in other nations would go far to relieve protectionist pressures.

Now, there has been some degree of recovery in this country. There has been some degree of recovery in other parts of the world. But as Senator Heinz indicated, we see a mercantilist pattern of trade emerging. We see that with Japan. We see that with Korea. We see that with Taiwan, with Singapore, with Brazil, and others. I cannot blame them. But aren't we, essentially, in terms of trade, going to see a massive continuation of this? Why should they change? Why should they change anything they are doing? We are the buyers. They are the sellers. They have it going in their direction. Why should there be change at their initiation?

Mr. STRAUSS. Two reasons they may change, Senator. One is in terms of growth, economic, worldwide growth. Senator Bradley has talked a great deal and probably knows as much or more about the third world debt as anyone in this country today, he will tell you that if we can get growth, for example, in the third world, and we can improve the economies—we get growth in the industrialized world as well, then the pressures to export unemployment to other nations are relieved a bit. And so if we get economic growth, we reduce pressures dramatically. We do not cure it, but we help. That is the first thing we do.

The second thing we have to do is the things you are deliberating on right now, is set out an economic and trade policy for this country to make us more competitive, where we can compete better, and, three, to put us in a position to deal with unfair trade practice by other countries.

We are talking about all these other things, but there are still, and don't you ever forget it on either side, there are unfair trade practices, of course. We are not without fault ourselves. But there are unfair trade practices. There are predatory practices that we need to come to grips with. And that is one of the requirements of this committee.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Senator Baucus.

Senator **Baucus**. Ambassador Strauss, I think you made a couple of very important contributions here, at least some ideas that I have not heard before, and with which I agree. Number one, raising the level of analysis in our country on trade matters from economic analysis to a political level, and also, as I undestood you, addressing trade problems not only as economic problems and trade problems but essentially as foreign policy problems as well. At least it is my view that as the world is becoming more competitive and is becoming more interconnected in economic terms, economic policy is doing more and more to drive foreign policy. That is very clear to me.

It is also, I think, clear that other countries—mercantilist countries, for example—are raising their domestic and internal economic policy to foreign policy, and therefore are beating us in many respects. Although we have not done that historically, we now have to begin doing so.

My question is, what are some of the foreign policy tools and some of the ways we can work, apply pressure, if you will, to reach agreements with countries, namely, Japan. One that I have in mind is national defense. I personally believe that we as a country can no longer continue to give Japan, Canada, Western Europe a free national security ride, by giving them a protective national security umbrella. They have got to begin to share some of the burden too. Approximately 6 to 7 percent of our GNP is dedicated to Defense, and approximately 1 percent in Japan—and I think it is 2 percent in Canada, and roughly 3 or less in western Europe. That might have made sense years ago, but we can no longer continue at that level.

So my question is, again, to repeat myself, what are some of the political and foreign policy tools we might utilize in order to encourage the kind of mutual agreement we are all looking for?

Mr. **Strauss**. Well, we made reference a minute ago to the third world. My recollection is that Japan took about 10 percent of the GNP of the third world, and maybe Europe about 20 percent, and we took about 55 percent.

Senator **Baucus**. That is correct.

Mr. **Strauss**. One thing we could do is encourage and insist upon the other industrialized countries of this world taking a larger share of the third world exports. That would relieve the import surge into this country from the third world. It would be very meaningful. That is one thing we could do.

I talked about in my remarks about capital requirements. We did supply capital, great resources to the rest of the world after World War 2. Those who are now exporting capital, the capital exporting nations, can certainly be looked to to take up some of the slack in that area and provide more capital to the less developed nations and improve that situation, take up that slack. Those are the kind of things I think we can do.

I think we can call upon, as we have called upon, other industrialized nations to stimulate growth and internal spending a bit. The Administration has been trying to do that. They haven't been very effective, but I think they have tried very earnestly and very hard. And they are getting some relief there.

Senator **Baucus**. That leads to the second idea that you have, your second major idea, which I think is good, and that is a summit with Japan. I frankly think that is critical, basically because, as you well know, the combined GNP of Japan and the United States is more than half of the free world's GNP. I think even though the other Pacific rim countries, to some degree, are imitating or copying Japan's ways in order to pull themselves up, that they are still looking at Japan. Japan can be a model also in a very responsible way. As Japan starts living up to its responsibility as the world's largest creditor nation and giving more foreign aid and helping to stimulate its investment, et cetera, the other Pacific rim countries will be forced to follow suit as well.

The question that comes to mind is, how do we lead a horse to water? And the horse I have in mind here is the White House, the Administration.

I do not mean to be partisan. I think that if trade policy is to be successful it has to be bipartisan. Being an objective observer, I do think that this Administration has not been as aggressive and forthright in trying to develop a positive trade policy as it should.

If the Administration continues to be not as aggressive as most of us in the country think it should, what should we in the Congress do? What kinds of legislation do we pass? Do we have to wait for a new President or what can we do in the meantime to help move this along?

Mr. **Strauss**. I think what you have done, Senator Baucus, in this committee is what you needed to do, and that is, send out the signal that there is going to be trade legislation. And my feeling is that the Administration is ready to be a player now.

Now, Secretary Baker has certainly been rather clear in his statements that he expects to be. And I see now a story in this morning's paper about the preparation the Administration is making to send up legislation. They don't want to call it a trade bill, but a rose by any other name. I don't care what they call the damned thing. If they send it up, it means they are getting their feet wet in this game now. And I think the Administration realizes that they need to go forward with the members of this committee, and the House Ways and Means Committee, and I think they will be a player.

Senator **Baucus**. Would pushing a new Department of Trade be a good idea?

Mr. **Strauss**. I am not at all certain. Senator Roth will murder me for not being more firm on that. But I will tell you one thing, he has pulled me a long way and others have. I think we ought to take a look at it. I don't quite know how you would do it.

Senator **Baucus**. Wouldn't that send a good signal? Finally, the United States is starting to coordinate its trade policy.

Mr. **Strauss**. As long as we realize that it is not a question that a new Department of Trade doesn't really do a damned thing unless it is done with a purpose of making us able to act more effectively and deal with problems more substantively. If we do it in that way, maybe it would work. I am not for creating another department in government. I want you to understand, or another bureaucracy. I am not for that. But it is possible that we could add some additional powers to the Office of the STR. It is possible that we could change some things around, then it might work.

I would certainly want—if I was on this committee, I would encourage some research and a good deal of work done in exploring it and taking a hard look at it.

As I said, Senator Roth has done a lot of work on it. I don't know how much he has changed from his original thinking, but his thinking has moved along as has mine.

Senator BAUCUS. I only mentioned it because, as you well know, 75 percent of all the goods and services produced in the United States today are in international competition. Our automobiles, our wheat, our services. It seems to me if 75 percent of our goods and services are in international competition, it makes some sense to have a little more authority in our government to vote to that.

Mr. STRAUSS. Yes, sir.

Let me add more, going back to your original point about Japan. You know, I am pro-Japan. I think our relationship with Japan is really vital. And I think that trade center that I talked about almost falls not as a trade but as a foreign policy initiative because it is absolutely essential we keep our business with Japan in good shape. And it is deteriorating right now.

We may think that the thing has quietened, but it is deteriorating in the eyes of the average man and woman in America. And we need to do something about it to preserve and strengthen that relationship. And the quickest thing we can do, and it is impacting more negatively in a serious way by trade issues, and that is why the trade summit idea was mentioned.

Senator BAUCUS. I agree with you. Thank you.

Senator MATSUNAGA. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Strauss, let's direct our attention once again to Japan. And you have dealt with the Japanese for many, many years, and we have had efforts made to get admission for our cigarettes, and citrus fruits, and baseball bats, and all kinds of sectoral items like that.

You specifically dealt with the telecommunications instance, and also you have stressed the point that once you get an agreement with Japan, the implementation of it raises tremendous problems.

What would happen if we really got to the ultimate and hardball with Japan and said to them, on telecommunications alone, look, unless you permit us to bid for your federal government contracts or your—I suppose it is all federal, their telecommunications——

Mr. STRAUSS. Yes.

Senator CHAFEE [continuing]. That you cannot bid for ours. We will not permit you to bid for any U.S. Government or—I don't know how far we can go with this; I suppose we can't get into the state government—any U.S. Government contract whatsoever. Now that's it. And a bid is a bid. And if we are a low bidder, if AT&T, or whoever it is, is a low bidder in Japan, that they cannot keep us out for licensing or certification or other.

Now suppose you, as STR, went there and did that, what would be the results?

Mr. STRAUSS. Well, I suspect that we would make some progresss if we took that position, Senator. But I would point out to you that it is—we talk about cultural problems there and other problems—what I really want to say to you, you could enter into a pretty reasonable looking, fairly tight looking agreement that you, as a former businessman, would have said, well, this is acceptable when your attorney presented it to you. And the implementation of it, if you don't have the will behind it, is still awfully difficult. Something seems to happen when you cross that border with your ability to do business in that country. And it is foggy, and it is misty, and I don't really understand it. And I am not sure that we would accomplish it; that it is as simple as you and I are making it sound right here. That is what I am trying to say. It happens in other areas. I am not sure it is as simple, but it certainly would get some attention.

Senator CHAFEE. Well, the only reason I chose this is that it seemed to me that—they are all complicated, but this is less complicated than saying getting shelf space for American cigarettes.

Mr. STRAUSS. Yes.

Senator CHAFEE. They might still choose not to buy Marlboros. But that is a cultural thing. But bidding low for a telecommunication system in Tokyo, wherever it is, it seems to me would appear to be clear cut. But you say there is more there than meets the eye.

Mr. STRAUSS. Senator, there is more there than meets the eye. And all you have to do is sit down and order a nice, quiet 1-pound steak—half a pound steak and let them charge you $60.00 for it, and see it sell in the stores for $40.00 a pound, for beef, then you know something has happened since that beef left the American ship. Something happens in that economy and no one quite puts their finger on it.

Senator CHAFEE. The only reason I chose the example——

Mr. STRAUSS. Let me make just one more point, because it is very important here.

Senator CHAFEE. Certainly.

Mr. STRAUSS. I want to point out to you—we are talking about Japan here, but I will tell you that in the European community you see the same things are taking place right now in telecommunications, and in Canada you see the same thing is taking place in telecommunications, the same thing.

Senator CHAFEE. But if we cannot prevail—the frustrating part to me is that this is a mammoth market in the United States, and constituents quite rightfully say, if we have got this mammoth market, why can't we do something about access to their market? Why don't we get tougher?

Mr. STRAUSS. And if I was going to get tougher, as you say, I would not do it on a bilateral basis, because you would improve your position and you would look better in the eyes of the world even, as well as acting better and more responsible. If you said, we were not going to permit anyone in any country to bid if we are not permitted equal bidding. Not just Japan.

Senator CHAFEE. All right. Well, that is fine. I think that is perfectly acceptable as far as I am concerned.

Mr. STRAUSS. I am not here making a defense of Japan, but I just say you are talking about an area now that requires a great deal of attention.

Senator CHAFEE. It seems to me that the example which you have chosen, the telecommunication is so much more clear cut than the other areas, like agriculture; that the government in Japan, the LDP, I presume, with their dependency upon the farm vote, is just not going to give on agriculture.

Mr. STRAUSS. That is right. And the European community cannot. They would like to get rid of the common agricultural policy. They cannot politically do it and survive. And they would like to get rid of it even more than we would. It is going to break the European community, the common agricultural policy with all the subsidies. But in an area such as telecommunications, they could do something about it. It is an easier political step for them to take. You are exactly right.

Senator CHAFEE. Now if you were king, what would you do to make that come about? No, let's not have a kingship involved.

Mr. STRAUSS. I like this kingship. Let's don't get into that.

Senator CHAFEE. Well, I think it fits you. But I have always looked on you in a regal fashion.

Mr. STRAUSS. Thank you.

Senator CHAFEE. But how does the United States go about, how do we affect it? What can we say to the Administration? You will agree that we don't want to press 301 too far. You, yourself, have said that you don't want to make it mandatory; something less than mandatory. What do we do here? How do we make an Administration, any President, be tougher?

Mr. STRAUSS. I think that you call before your committee certain members of that Administration, for example, the chairman of the cabinet council, which is Secretary Baker, and you call before them the STR, a very able man, Clayton Yeutter, if it is the will of this committee, and after taking testimony, you make the point of view that you just expressed very clearly to them, that you expect the Administration to explore the taking of such a position or maybe legislatively mandate it. And then you begin to get attention. You would get King Strauss' attention.

Senator CHAFEE. Well I am for that idea.

Let me ask you one other quick point here. The question of the fast-track I deeply believe in and you have indicated you do also.

Mr. STRAUSS. Yes.

Senator CHAFEE. Would you once again stress to the committee how important you feel it is that we pass that law, or extend that law again?

Mr. STRAUSS. On a scale of 1 to 10, it is a 10. There is no question in my mind that it must be passed if you hope to have a successful negotiation. And if I represented the Europeans, the Japanese, or others, and you did not have fast-track legislation, I would say this negotiation really means nothing. They are going to amend this thing to death when it gets back. It is going to sit awhile, and nothing will happen. And why should I put this on the table and then have it bit on here, and nibbled on there, and torn apart here, and then you come back and insist that I do this, that and the other. I want to know when we shake hands and walk out of this room, that is what your Congress is going to vote up or down on or I won't go.

And the truth of the matter is, people will go 25, 30 percent further if they know you are not going to be coming back and nibbling again and re-trading a traded deal. It is the same old story. If you think it is a final trade, you will give the last dollar. If you think it is going to come back, you will hold back. And that is just what would happen to you.

Senator **Chafee**. And we could not have gotten that agreement in 1979 absent fast-track?

Mr. **Strauss**. No way. No, you couldn't have without fast-track. No question about it.

Senator **Chafee**. Thank you.

Thank you, Mr. Chairman.

Senator **Matsunaga**. Senator Bradley.

Senator **Bradley**. Thank you very much, Mr. Chairman.

You kind of like the "King Strauss"?

Mr. **Strauss**. Yes, I did, Senator.

Senator **Bradley**. All right.

Mr. **Strauss**. Unless you have got something better.

Senator **Bradley**. How about "Viscount"? [Laughter.]

The Japan-U.S. bilateral deficit is $54 billion. Now the USTR says that if there were no trade barriers to our exports to Japan, we would improve that by about $5 billion. The highest number I have seen is $10 billion for Japanese trade barriers.

Now what other things do we have to do, in your opinion, in addition to trying to get access to their markets?

Mr. **Strauss**. Well, one is market opportunity and access. And the other is the ability to take advantage of it. Those figures may be a little bit low. I have never measured those figures. If I had to pull a figure out of the air, I would pull a bigger one than they have pulled out. I don't know how much bigger. Because I know a great many things that we can sell in Japan successfully. You can begin with rice, and you can move to agriculture, and you can go from there to telecommunications, and you can go with the various high tech things that we still do very well with the Japanese on, and on and on.

So I think we can do a bit better than that. I think now though you are getting into what I call, other than the trade policy issues, you are getting into the basic issues of this country.

We need interest rates to come down, more R&D, better training, improve our education. You are talking about a long-term pull of improving that word "competitiveness" again.

Senator **Bradley**. So that of the $54 billion bilateral deficit with Japan, a portion of that is due to trade barriers in Japan, but there is a big part of it that is due to a variety of other things.

Mr. **Strauss**. No question that the Japanese are more productive today than we are.

Senator **Bradley**. Ambassador Strauss, the thing that comes through in your testimony that we really haven't heard in the committee sufficiently, I think, is the extent to which there is a political-economic connection. The image of Clayton Yeutter sitting next to Ronald Reagan at the next summit is, based on past experience, ludicrous. The chance of it happening is not high. And yet, as you point out, it is an essential part of a successful negotiation for the person you are negotiating with to believe you have access to and are speaking for the President.

Mr. **Strauss**. Correct.

Senator **Bradley**. Now let's assume—given what you have said about deficits being caused by a variety of problems—third world debt, macroeconomic imbalances, et cetera—let's assume that you were going to prepare for a multilateral negotiation, and that the issue was not just trade law. What would you want each country to do? If you wanted to get this trade deficit down and get equilibrium worldwide, et cetera, what would you want Japan to do, first choice, second choice; what would you want West Germany to do, first choice, second choice; what would you want Mexico to do; Brazil, Korea? Assuming that they were all willing to pull, and assuming that you could overcome some of the political obstacles because of the expertise of the STR, or whatever, what would you want them to do?

Mr. **Strauss**. Well I suspect that if I was dealing with Germany I would want them to improve their—stimulate their growth a bit, and also I would like to see them assist a bit more with the third world debt, as well as taking some of the third world products.

Senator **Bradley**. So that in Germany you would like to see more stimulus either by cutting taxes or by spending more money and reduction of interest rates.

Mr. **Strauss**. Those are the things to do. And I don't talk about inflationary spending. I am talking about responsible actions that you would expect out of a responsible government, such as Germany, with responsible economic measures. Then I would go to France and I would talk a bit in Germany. I would talk to both of them about their telecommunications, for example.

There is a classic case going on right now in telecommunication that I won't dwell on right here now. It has to do with our ability to sell where we are competitive and their ability to keep us out, even though we are competitive, to keep the business at home. So I think I would talk about that.

I would certainly talk about agricultural subsidies in Europe. That is one of the major problems that this nation and the world face. That not only hurts us, but what they are doing, you can take, oh, anywhere from dumping sugar on the world market at 4, 5 cents to what they are doing with wheat. The common agricultural policy is a heavy millstone. around the neck of the Europeans. It is about to bust them and they can't get out of it.

Senator **Bradley**. I don't want to interrupt your list of other countries, but you hit this common agricultural policy and you have a lot of experience. What is the way to reach them on this?

Mr. **Strauss**. I think that the Europeans, generally speaking, are sort of like sometimes our American politicians, want the pressures put on them to do the things that they know need to be done. And the Europeans know they have to deal in the next few years with the amount of money that is going into the CAP or it is going to break up the whole common market. They are going to end up fighting over it.

Now they got Spain and Portugal in there now and it is a constant day to day squabble over this issue. And they would like the kind of political pressure, I say, that many American political leaders want on them to force them to take some steps that they know should be taken.

Senator BRADLEY. Those pressures should be brought to bear how and when?

Mr. STRAUSS. Externally they need to be brought to bear. They cannot bring it internally. The German Chancellor cannot put the pressure on his representative to the EC because, if so, he will not be German Chancellor the next time.

Senator BRADLEY. So should the United States at the Uruguay Round make as one of its priorities putting serious pressure on the European agricultural policy?

Mr. STRAUSS. No question in my mind that it should. No question in my mind that it should.

Talking about selling wheat to the Russians, the Russians are not taking the amount of wheat they agreed to buy in this country. The Russians haven't defaulted on anything there, as I understand that agreement. It says, so long as it is competitive at world prices. We are not competitive at world prices because they are dumping it on the market at, gosh, I don't know, maybe it is two-thirds subsidized. Maybe it is two-third subsidized, or more.

Senator BRADLEY. Thank you.

Senator MATSUNAGA. Mr. Roth.

Senator ROTH. I would like to go back briefly to the Trade Department. As I see it, I agree with you. I think we need an aggressive trade policy in this country. But to support an aggressive trade policy, it seems to me you need two other things, and that is, of course, the right man, a Bob Strauss, as the principal negotiator. And I think Mr. Yeutter has got great confidence, so I don't mean to deflect against him. But I also think it is critically important that we have the kind of organization. And one of the reasons you were so successful in your case was that you had the ear of the President, but not every trade representative is going to have that position.

Now take the Treasury. It really doesn't make any difference who is Secretary of the Treasury because that is a strong organization. The man or woman that assumes that position becomes the key player at least 90 percent of the time.

So doesn't it make some sense to try to get some kind of organization where you know who is in charge at trade policy, where you know he has the right to participate in Security Council meetings if they are discussing trade, or Cabinet, rather than to leave it to the division that we now have in our organization aspect?

Mr. STRAUSS. Senator Roth, it makes some sense, of course, it does. And that is the reason I say that we ought to take a very serious look at this now.

Senator ROTH. Something I would like to continue to explore with you. As I say, I have no fixations on exactly shaped, but I just think that if this is going to be a top national priority then we have to have some kind of organization and not the rivalries and the bureaucratic fights that we have had too often in the past.

Mr. STRAUSS. Yes. For example, we would exclude Agriculture from being under that. That might make it easier to get passed and easier to—and more effective. There are a lot of different things we can do.

And let me just, without being presumptuous, say to you, that you and I have had a lot of conversations and correspondence, and I know the time you and your staff spent on it. If I could ever spend any further time with you, you know, I would be delighted to on this subject, for I learn for myself.

Senator **Roth**. Well, we made a little progress during the Carter years in reorganization.

Mr. **Strauss**. Yes, we did.

Senator **Roth**. Thanks to you.

I think you have, as always, some very interesting ideas, and I like your suggestion of a summit conference of some type with Japan. And I think the time may be right.

A second Democrat, who I have the warmest admiration and respect for, is Mike Mansfield, who has been our ambassador. So it seems to me that the timing of this could be very critical.

Mr. **Strauss**. Yes.

Senator **Roth**. I guess exactly what should be our goals? I would like to go back a little to what Senator Packwood talked about. We can open up everything, and some people say, well, you still will only achieve a better balance of maybe 5, 10, 15—I cannot remember what the figure was—billion dollars, but you will still continue to have a major imbalance.

Should we go beyond that—in your case of Hong Kong— could we require some kind of reciprocity? Should that be a goal? Or if we move this direction, what should be the——

Mr. **Strauss**. Senator Roth, I don't think we make much progress in requiring people to buy something they don't need because they are not going to do it. Or to take a product that is not competitive with their own. So I am sort of hesitant to get into this reciprocity thing. And I think we would approach that summit, telling the American people when they went there that we are not going over to be able to wave a magic wand, and come back, and say this time next year this trade deficit with Japan will be $15 billion less. It might be $3 billion more the following year and you still have had a good summit, because you put in place things that are going to take a long time, a number of years, to become effective.

So I think you would talk about a whole strategic approach to the relationship, the economic relationship between these two great nations.

Gosh, I know people who talk about the idea that we ought to joint venture more with the Japanese, and sensible people, very bright ones, who have got some ideas for joint venture.

Mike Mansfield, who you just mentioned, has been speaking out on some kind of new bilateral treaty he wants to get into, much of the kind of treaty we are attempting to negotiate with Canada now. I must say, the Japanese have not been very warm to his idea, but he has launched that out. He has been talking about that in some of his conversations.

There are a lot of things floating around out there. But this would take the kind of preparation. We don't do any more for summits. It would really take six to 12 months of hard work, and then with a mandate to implement certain things within a time certain. That is the kind of thing I am talking about.

Senator Roth. I think it is a very worthy proposal, and I think it does require a strong bipartisan approach if it is going to work.

Mr. Strauss. Very definitely. And it requires the Congress to participate with the Executive branch, as well as the private sector. I am talking about a real summit to accomplish something.

Senator Roth. Mr. Ambassador, I have been a strong proponent when you were here, as well since, of trade adjustment, and as part of the trade adjustment the need of retraining our workers. It seems to me that those that are impacted are deserving of special attention to let them find new jobs.

Now I had proposed a couple of years ago or so that to pay for this kind of a program we ought to negotiate some kind of a small fee in gas to permit some kind of a small import fee to pay for the cost of this kind of progeam. To me, that makes sense, because those that are being negatively impacted upon ought to be helped by those who are being favorably assisted by getting what they think is a cheaper or better product.

Would you support this kind of approach?

Mr. Strauss. I don't know whether I would or not, Senator Roth. I hear that there is another approach going around that I think you are going to hear more from before you get to your deliberation, that the House Ways and Means Committee, I think, looked at last year, that is, this idea of marketing our quotas. They are selling our quotas instead of giving them away, and using that income, or a portion of it, just for the kind of purposes you are describing.

I think that is an idea that you are going to hear more about. I have no opinion on it. And, as a matter of fact, I am negative rather than positive on it as of the moment.

I have got some of my best fair trade friends, or free trade friends, who are now making the argument that that is not a protectionist policy and it could really be good trade policy. I haven't swallowed it yet. I think you have to say very fast if you are going to believe it. If you say it slow, you will get in trouble.

Senator Matsunaga. Senator Riegle.

Senator Riegle. Thank you, Mr. Chairman.

Mr. Strauss. That's right.

Senator Riegle. Excuse me, did you have a postscript?

Mr. Strauss. No, sir.

Senator Riegle. If it's a good one, save it for me.

Mr. Strauss. All right.

Senator Riegle. I appreciate all the good suggestions you have made today. I think they are helpful, at least to me, in my mind. You haven't quite gone all the way, but the idea of establishing a Cabinet department on trade I think clearly is something that needs to be done, and we obviously need a strong player in that job. I hope we can take that step.

I appreciate, too, the point you make about the fast-track. The problem is, if you have a bad policy, a fast-track gets you the wrong outcome. So if we are going to get on the fast-track, let's be sure we have got a policy that is going to take us to results at the end that we want.

Mr. Strauss. Well, the Congress has the last bite at that apple, you know.

Senator RIEGLE. Well, I understand, but we haven't done very well on that. It seems to me that we have been way behind the cure. You have got new people running the Congress this time. Maybe we can do a little better. But we haven't done it very well in the recent past.

I want to try to take you to a part of this debate that we really haven't spent much time on today. And I want to say one thing before doing so, and that is, in my view, we are in a trade war. There is a trade war going on and we are losing it. The numbers, I think profoundly bear that out. I want to talk for a minute with you about the impairment of our financial position. Earlier I referred to this chart where we have gone into this debtor nation status, but I want to draw your attention to the slope of that line, because this is a graph that is to scale. And the thing that reminds it me of most was the photograph that an amateur photographer got of that Air Mexico plane that had its tail sheared off in Southern California, and it was plummeting to the ground, and somebody took a picture of it, and that was about the rate at which it was headed to the ground.

As I watched the Japanese take possession of what was U.S. capital, because we are spending all this money, and I will just take the Japanese for the specific case in point. We get the video recorders and we get the cars and so forth and so on, and they get our capital. And the capital, of course, is enduring. The goods wear out but the capital has a wonderful quality of lasting if you don't squander it.

They now are in an enormous surplus position just as we have become the number one debtor nation. And all this money that used to be ours is now theirs. They are lending us some of it. They are coming in here in many ways buying a lot of prime real estate, as you are well aware, in your home state of Texas, as well as New York, across this country. But, increasingly, they are doing something else with it. As prudent investors, they are buying high technology—small firms in this country—and in a sense, coming in and buying up a lot of the technology that relates to the next generation of invention and advancement and improvement in our society.

Now I don't make this as a specific point to them. It just happens to be that they are the ones that are doing it on a large scale in terms of a particular nation. But I am concerned about the consequence for us.

Now if we are going to owe the rest of the world a trillion dollars by 1990, you know, I don't see for the life of me how we handle that kind of a situation. I don't see how we cope not only with paying the interest on that—I don't see where that money is going to come from. Obviously, somebody else is going to have to pay it in the future—but as they recycle these dollars, and come back in here, and have a larger and larger strategic impact on basic decisions within our own manufacturing and production base, aren't we putting ourselves in a position where we increasingly, if those trend lines run on, our economic decisions become a hostage, to decision makers in some other country.

I mean, isn't that the pattern that we are seeing? And have you ever seen anything like this in your lifetime? I can't find it in the history books.

Mr. STRAUSS. No, I haven't. But let me get started, Senator, first, to make a distinction. You see, we tend to get apples and oranges mixed up here. First, you have to draw a distinction between a trade deficit that has nothing to do—you don't repay a trade deficit. You run a trade deficit. You try to correct it. But those are not dollars that you have to repay as being a debtor nation because we run such big deficits, budget deficits, and those are dollars that we have to repay. And we owe that money to foreigners—Japanese, Europeans and others—who are buying our bonds and other things, to help us finance our deficit.

What is happening is we are taking in dollars and spending it on day to day living, and the people who have those dollars are spending it on capital investments in buying the kind of assets you just described. It is like a family, one who invested in a home, and furniture, and in land, soil to till, and the other who spends it each day on ice cream and liquor or clothes or other worthwhile ventures, in my judgment.

But there is a distinction there, which brings me to this theme that I talked about. We have to do somethig about our budget deficit in this country.

Now in terms of what is happening on buying things in this nation, let me give you a good example of the kind of things that disturb me a great deal, more than many of these other things we have talked about.

Let's talk about something you understand very well, the auto parts industry. And other Midwestern Senators particularly understand that.

What has happened is that not only do we now have Japanese bringing—selling their automobiles and bringing their automobile manufacturing facilities into this country, but now we go to a second stage. And the second stage is the tremendous, unbelievably high percentage of people in this country—I forget the figure—are engaged in employment in the auto parts and related industries. Now those are in here. First, they come in to service the Japanese automobiles, to provide parts to service those cars. Now you find that being expanded in acquisitions made where we begin to compete with the big three.

Senator RIEGLE. Well that's already happened, as you point out.

Mr. STRAUSS. Now that's happened to you. Now that's putting us in a very serious posture.

Senator RIEGLE. You are exactly right. But I want to take you back to one thing because this is a new topic and generally we are not prepared to discuss it because we are still behind the curb. We are debating the results of missed opportunities over the last five or 10 years.

This year, the trade deficit with Japan, through November, was $58 billion. We just got that from the trade representative. I would assume for December there was at least the same monthly amount, probably more than that, because there was a whole burst of trade in December. So probably 63-plus billion dollars deficit just with Japan last year.

Now that reflects the net outflow of economic wealth from us to them. Now it is true, they are willing to lend that money back to us—and they are doing it now, they are lending that money back to us—but they are not obligated to do it.

The point I am trying to raise with you, and it is a hard one I think for us to start to think about, and that is, I think we are putting ourselves in a new kind of jeopardy, because we are creating a financial imbalance which this chart illustrates where we now owe the rest of the world—Japan first on that list but others behind them—more and more money all the time. And it just doesn't seem to me. that we can continue to do that and go in that hole. I think we need a more abrupt change in these patterns.

I don't think you can have incrementalism here, where you get that trade deficit down 5 or 10 billion dollars. I think we have got to cut it in half, because I don't think you can let these trend lines continue for another five or 10 years.

Mr. STRAUSS. Now I want to change that. This has to do with the savings program in this country, our whole mentality. These are cultural changes that you are talking about that we have to get at and they don't come about overnight. Because our credit rating as a nation is in jeopardy.

Senator RIEGLE. That's exactly the point I am making.

Mr. STRAUSS. I want to go back and make one quick point here, Senator, about our discussion on telecommunications, when you said, if you don't do this, we won't do that.

The one point I failed to mention in there, the down side on that is where you get into this sort of a game of chicken on that is they say, well, we are not going to take in your agricultural products. We are your biggest purchaser. We are not taking any of that if you do this. And then you say, well, if you don't take our agriculture we are going to do that. And then the whole damned thing begins to deteriorate and break down. That is the danger in the kind of policy we talked about, and that is the reason people are slow to use it. Excuse me.

Senator MATSUNAGA. Senator Danforth.

Senator DANFORTH. Mr. Strauss, I was not here I'm sorry to say for your earlier discussion on telecommunications. As you know, Senator Bentsen and others have introduced the telecommunications trade bill. Some say that it is a sector specific trade bill, and that for that reason it should not be enacted. Others say that telecommunications is a different kind of issue; that telecommunications is an area where we did have a tremendous advantage; that divestiture of AT&T amounted to a unilateral trade concession, and therefore we should enact a sector specific telecommunications bill.

You may have addressed this already, and if so, just say yes, I have already addressed it.

Mr. STRAUSS. We did it in terms of your bill, Senator Danforth, earlier. Senator Bentsen described the legislation the two of you sponsored.

Senator DANFORTH. I see.

Was your answer basically supportive?

Mr. STRAUSS. Yes, supported.

Senator DANFORTH. Supported. Even though it is sector specific?

Mr. **Strauss**. Yes. In the first place, we need something faster, and this is fast, for one thing. It is effective. I was supportive.

Senator **Danforth**. All right. Do you think that opening markets in other countries, particularly Japan, amounts to a pipe dream? Those who have opposed truly protectionist legislation have said that what we should try to do instead of protect our own market is to open up other markets, and that any legislation should provide leverage for opening other markets. We should be tougher. We should be willing to retaliate at times. The goal shouldn't be closing the U.S. market but opening other markets.

Japan, in particular, has been a pretty tough, very tough customer. Sometimes it seems as though concessions are illusory: the announcement of action packages amounts to nothing, promises amount to nothing. Americans who make a good faith effort to go into their market hire people—get into joint ventures with the Japanese and the like, and end up just beating their heads against the wall.

Do you think that the goal of attempting to open other markets remains the sensible approach?

Mr. **Strauss**. Yes.

Senator **Danforth**. Or is this something that is just a pipe dream?

Mr. **Strauss**. I think it remains a sensible approach. I think you have to be pragmatic when you look at it and know how tough it is, particularly in the case of Japan.

While you were out of the room, I proposed a new kind of summit, a Japanese-U.S. summit. It would be prepared altogether differently from others, and with Congressional involvement, and elevating it to the highest possible political levels, and different kind of preparation, and different kind of publicity, and different kind of commitments, and a different kind of time frame in which you hope to accomplish something. And I don't think that would solve all of our problems, but it might solve 10 percent of them with Japan, or 15 percent. It might put us on a course.

I described it as almost a foreign policy initiative to preserve our relationship with Japan, because I think if we don't solve some of these problems, the relationship with both countries is going to deteriorate.

I think that countries such as China present great marketing opportunities for this country and we ought to pursue it. We see marketing opportunities in other European countries. They ought to be pursued aggressively. But I also think you need leverage. You need leverage to get into these markets.

Senator **Danforth**. Would you agree that there are times when we have to retaliate to maintain our credibility?

Mr. **Strauss**. I certainly do.

Senator **Danforth**. It would have to be more than just talk. Correct?

Mr. **Strauss**. I certainly do.

Senator **Danforth**. Do you think, where Japan is concerned, that they view us as windbags, people who talk, and maybe cry babies, but mostly as people who are never willing to retaliate?

Mr. **Strauss**. If they have any sense, they do. And I think they have some sense. We have been a lot of huff and puff and damned little action.

I would love to see a list of how many members of the Congress, how many trade representatives like me, how many others who have been over there and said, now if you don't do something the Congress is going to do so and so and so and so.

Senator **Danforth**. Oh, I do that many times.

Mr. **Strauss**. I have done it many times, and thought, my gosh, I was wonderful in that presentation. And I could see them back there taking a drink afterwards, saying, well, we got rid of that fool. [Laughter.]

Senator **Danforth**. Well do you think that one element of legislation should be to make retaliation for certain?

Mr. **Strauss**. Well I am hesitant to get out. I am willing to climb out on the ledge, but I don't want to die on that one, Senator Danforth. A lot of it has to do with, as I said earlier, what the priorities are of the man who sits in the White House. And his successor to President Reagan, Democrat or Republican, might be altogether different on trade policy, to take much more interest in it, make it a higher priority in his Administration, and makes some other issues that he has made a priority lesser. And we can argue whether that is good or bad. In my judgment, it would be good.

Senator **Danforth**. What do you think we should do then in Congress if we pass a trade bill? Mainly, just turn up the volume?

Mr. **Strauss**. No. I think there are a number of things you would look at, some of the things we have talked about today. I really don't think it is appropriate for me to try to be specific. I don't have a litany of if you will do one, two, three, four, five, you will land on space six. I don't think that would make any sense. But I think there are a lot of things you can look at, all the way from the Canada negotiations, supportive or otherwise, with the bilateral negotiations we are having with Canada, to the kind of trade some of it I talked about to Japan, to instructions you give the STR and others.

Senator **Danforth**. I am afraid some of it has to have some agenda, doesn't it?

Mr. **Strauss**. Yes.

Senator **Danforth**. I mean, when we have any trade summit we have to be willing to say to the Japanese, here is what we want, and if we don't get it then something bad is going to happen.

Mr. **Strauss**. Senator Danforth, I think it not only has to have an agenda. I think it has to have a carefully spelled out agenda that has been approved by the members of this committee and the Ways and Means Committee. I think you need to have representatives there attending that summit. I think the White House must be committed to it. I think the President must take a lead in it. I think the STR and the Secretary of Treasury should be at his side.

Senator **Danforth**. But we have to decide if it all falls apart that we are going to act in some specific way.

Mr. **Strauss**. You have to decide not only what you are going to do to get in, but you have to decide what you are going to do to get out if it comes unglued. But I think those are the kind of things. But that is going to be prepared unhappily. The way we prepared most of these summits recently is in the kind of dialogue you and I are having when it really ought to be prepared by a dozen people like Dean, me, or whoever we want to pick who would work on those issues and do it for six months before we got there.

Senator DANFORTH. Thank you.

Senator MATSUNAGA. Senator Pryor.

Senator PRYOR. Mr. Ambassador, you have been a wonderful witness this morning. I think this has been a great education for all of us, period. Now I am going to ask you a hypothetical question, and I hope you won't think it is too facetious. To a degree it is taking off from where Senator Danforth stopped.

Let's just say in a hypothetical vein that you go back down to your law office this afternoon, and you have lunch, and at about 2:00 o'clock the telephone rings, and it is the President of the United States on the telephone. And you say hi, Mr. President. And he says Bob—or Mr. Ambassador, whatever he calls you—I have been watching C-Span this morning, and I have enjoyed very much your testimony about this issue of trade. Now, at 4:00 o'clock, Mr. Strauss, I would like for you to come to the Oval Office, and you have five minutes to tell me what to do, what steps to take next, and what the real priorities are to get this trade deficit at least on some sort of a glide path. You are going to have five minutes. And I hope you will come down here and tell me what to do, Mr. Strauss.

And then Mr. Strauss says, thank you. I will be there. So what would Mr. Strauss tell the President at 4:00?

Mr. STRAUSS. I would say, Mr. President, you ought to call those engaged in trade in your Administration, the Secretrary of Treasury, the STR, and others, you ought to call them into your office five minutes after I leave here, and you ought to say, gentlemen, I want the issue of trade, trade policy in this country and economic policy in this country put on its high priority basis as I have told you six years ago I wanted Defense. I have got two years left here, and I want to accomplish something in that area before I leave. And you now have my full authority and support. And I want you to come back within one week, or two weeks, or three days and tell me where we are going next so I can sign off on it or reject it.

Senator PRYOR. Thank you, Mr. Ambassador, and thank you, Mr. Chairman.

Mr. STRAUSS. Yes, sir.

Senator MATSUNAGA. Mr. Daschle.

Senator DASCHLE. Thank you, Mr. Chairman.

I think that your testimony certainly confirms one thing, Mr. Ambassador, and that is that we really have to look at this whole issue from two perspectives: the foreign impediments and our own domestic impediments that have been brought about by our own doing.

And I would really like to focus on the latter rather than the former for a couple of minutes, and try to better understand what you are saying about those domestic impediments today. You have been there. You know the kind of complete disarray that decisions relating to agriculture and trade, various kinds of equipment that are forbidden to be traded. All of these elements are subjected to a great deal of cross-pressure.

If we don't create an international trade mechanism, a new Cabinet level agency, how is it that we put trade on a high priority? What is it that we have to do specifically with regard to the bureaucracy that exists today to ensure that that trade position has the kind of attention it deserves, regardless of who is President today?

Mr. **Strauss**. Well the first thing you have to do is create a political consensus, Senator, for action in trade. The political process that you have obviously mastered, or you wouldn't be sitting on this Finance Committee, as you are today, requires political consensus to get action. We don't really have a political consensus in this country. People talk about it. But, you know, you go to Pittsburgh and the steel worker there complains about imports into this country taking his job, but he is driving a foreign car and he is wearing a foreign watch, a Japanese watch.

And if you talk to people, there is no consensus in this country to do anything about trade. There really isn't. Trade hasn't been a burning issue in any of the elections. We talked about how it is going to be at the top. It isn't at the top.

The first thing you do is make the American public aware of it. Create a consensus, a political momentum. Without that, nothing takes place. They start burning up your home state and they will keep your feet to the fire pretty good.

Senator **Daschle**. Why do you think that consensus exists in other countries where it doesn't exist here? Do we have a role model out there somewhere?

Mr. **Strauss**. Well, in Europe, when you read a European newspaper or a Japanese newspaper, interestingly, the stories are all about—the feature stories are about what is going on in trade: who bought what, and who sold what and what took place. And here you go over, and it is page 2 of the business section, or three. And the public is aware of what is going on in trade.

You touch a little, delicate, sensitive nerve on a European trade issue and the whole continent lights up. And they all read about it and hear about it on television. It doesn't take place in this country.

Senator **Daschle**. What tools do you think the equivalent of an STR has in Japan or in Europe that you did not have and that Clayton Yeutter doesn't have today? What are those tools that you take in a negotiation that you ought to have that you do not?

Mr. **Strauss**. I had every tool I needed. I was not short a single tool. The only tool I was missing that I could have had is knowledge. I was short on knowledge when I took over the job. I didn't have a background in it. But I learned pretty fast and I had awfully good people with me. And I had the support of the Republicans and the Democrats on both committees. I had the support, the leadership on both the Minority and Majority leadership.

I will never forget Congressman Roe saying to me when he took me before a group of Republicans, and he said to the Chowder in Washington Society, he said, after I finished with my presentation on trade, now you go on back over with your crowd on the other side and tell them we will deliver a higher percentage of votes than they do for your bill. As a matter of fact, we may do it unanimously. And they damned near did. I think we lost one or two Republican votes, two or three Democratic ones.

I had every tool I needed and the support, except there is one thing that maybe we don't have, that I didn't have. I didn't have a background, nor we don't train people. We don't have a sufficient institutional memory and experience factor in this country. I think that is one shortcoming. And maybe for the kind of problems we are dealing in now, our institutions aren't just right.

Senator Roth has talked about reorganizing it, and we ought to look at that and see if we can make it more effective.

There is one thing for sure, we ought to try to see that a STR, or whatever replaces him, has a more significant relationship with every President. It doesn't just depend on the individual. As Senator Roth points out, the Secretary of State, the Secretary of Treasury, Secretary of Defense, they have a built in relationship. Others have to create that relationship.

Senator DASCHLE. I doubt that you were still there at the time, but I can recall one time when the STR should have had that kind of year that didn't even in the Carter Administration and that was the grain embargo of 1980.

Mr. STRAUSS. I was not there.

Senator DASCHLE. Clearly, you know, we could have used somebody like you at that time. But that probably is illustrative of the problem we have with regard to these cross pressures in trade as it exists in recent history.

Mr. STRAUSS. That is right.

Senator DASCHLE. And what I am asking is what is it that the STR has to have in order to prevent that kind of interbureaucracy fighting and that kind of prioritization from being effective in the future?

Mr. STRAUSS. Well it is not just the STR. You need a better way—what we are trying to seek is a way of improving the making of trade policy in this country. That last example you gave, in my judgment, was exceedingly poor trade policy and never should have taken place. And history has proven that to be right.

I think it is interesting to see. There were plenty of mistakes that were made during the Administration which I served in the trade field. I am not trying to say we were perfect. I am just trying to say that in my duties I had the kind of support I needed. Look at those reports. There were very interesting reports to come out on export, on this whole export of sensitive material, a fascinating report, and coming down on the side of the Commerce Department and in opposition to the Defense Department. I happen to share with you that report. That's the kind of thing.

Senator DASCHLE. Let me just follow up with the last two questions. I see I have the yellow light.

We have two tools right now that have been used both for the United States and against the United States. The impediment to the trade of technological equipment still is one of the biggest tools I think used against good, constructive trade policy that exists. Would you remove that, number one? Number two, what would you do with export enhancement in agriculture? If you were STR today, would you advocate its permanent installation as a trade tool or would you say that it ought to be abandoned completely?

Mr. Strauss. Well I think there are certain things you can do. For example, in that last trade bill they called for an agricultural export position to be in the White House. But it was never filled just right, or it wasn't filled properly. It kind of brushed aside. That is one thing. That kind of initiative might be helpful.

I really don't know enough about it. I wouldn't want to pass judgment on the other.

There was another question you asked.

Senator Daschle. I was asking about export enhancement and then the prohibition currently on technological equipment.

Mr. Strauss. Oh, yes. The prohibition, I think that hurts us in the technological development and our export program. It hurts us, compared to this, all the way across the board.

Senator Daschle. So you would eliminate that?

Mr. Strauss. I would not eliminate it. I would certainly improve upon it dramatically, and where you could just stop all this foolishness in companies from exporting where they should be able to.

Senator Matsunaga. Ambassador Strauss, I wish to commend you on your presentation. As usual, I think that practically everyone on the committee agrees with your presentation.

Senator Chafee. Mr. Chairman, if we had a question or two more, would that be——

Senator Matsunaga. I haven't had my question yet.

Senator Chafee. Oh, I appreciate that. But after you are through could we have another round, a couple of questions?

Senator Matsunaga. If you have any.

Senator Chafee. Thank you.

Senator Matsunaga. The thing I appreciated most about your time as USTR is that you consulted with the members of the Congress, members of this committee, prior to taking definitive action. We had our say. We had our input.

I recall the time when you were negotiating with President Marcos. You came to me and said, "Sparky, President Marcos insists on eliminating the 14 percent tariff on pineapples. How would this affect your state?" I responded, "Well, our pineapple industry would go bankrupt." And you said, "But President Marcos insists on it, and I can't proceed further unless I agree to that."

So I asked, "Supposing I go and talk to President Marcos, and he agrees with me to withdraw, from his expressed position, then will you agree to that?" And you said, "Well, of course." So I flew to Manila.

Mr. Strauss. I remember it well.

Senator Matsunaga. And I told President Marcos "If you insist on your position, the Hawaiian pineapple industry is going bankrupt. And do you know who are going to become unemployed? The Filipinos. And what Filipinos? The Ilokanos, who come from your province. They constitute 80 percent of the work force in the pineapple industry." And he said, "Well, we can't have that. Well, okay, fine. You tell Ambassador Strauss that I will yield." And, of course, I told him to put it in writing.

Mr. Strauss. As a matter of fact, Senator, you only erred in one bit of that story. You told me that story first and I found it persuasive. And I said, why in the hell don't you go tell that to Marcos.

And you said, well, I will if it's all right. And I said, I can't do it; you do it. And you did.

Senator MATSUNAGA. Yes, I did, and from that one experience, I am very much elated over your suggestion that we have a composite negotiating team consisting of Executive as well as the Legislative representatives. In my view the USTR office would not have been as successful as it was in the Carter Administration had it not been for your personality. And perhaps as members of the legislature we can add to that total personality. For that reason, I was wondering what your ideas were when you suggested that perhaps the time has come for the establishment of a Department of Trade, a Department of International Trade. Do you mean that this would mean the elevation of the status of that USTR to the point where perhaps the foreigners will look upon the Secretary of International Trade as one being closer to the President?

Mr. STRAUSS. Whatever they call him and whatever structure you have, whether it strengthens or weakens the Commerce Department or strengthen or weaken the STR, I think if it didn't put the person who had responsibility for trade in a stronger role in tbis government then I would not be in favor of it. And I think he should have a stronger role, and he would be able to be more forceful and effective.

Senator MATSUNAGA. Now, I don't know whether you have heard of what Ambassador Mansfield said very recently in Honolulu. Ambassador Mansfield made points similar to yours when he said, that much of the trade imbalance rests with the United States. One of his points was this. American industry must sharpen its productivity, quality control and service and court the consumer.

I am reminded of a diplomatic family, coming over from Japan. This couple was riding in a car with their 10-year-old daughter from the airport to the embassy. The little girl looked at a familiar site, the golden arches, and said, "look, mommy, daddy, they've got McDonalds here too." You see, what we need to do is to do what McDonalds has done—make McDonalds a part of the foreign market.

We have been trying to break down barriers. Sure. We say we've got to break down the trade barriers. We've got to insist that Japan buys more of its telecommunications equipment from us. But if Japan were to buy all of its telecommunications consumption from us, it will mean $4.3 billion annually. Not a significant dent in our $57 billion trade deficit.

We need to sell American products to the Japanese so that they will begin to look upon American products as part of their daily consumption habit. Otherwise, we are not going to be able to eliminate that trade deficit. It just means that we have got to sell more instead of buying less. Do you agree with that?

Mr. STRAUSS. Well there is no question we have to sell more. There is no question we have to. And I would hope that we could buy more of our own products as well as sell more of our own products.

Senator MATSUNAGA. Do you agree with one of the suggestions made by Ambassador Mansfield that we must court American consumers as we once did because American consumers are preferring foreign products and buying foreign products over American products?

Mr. **Strauss**. There is no question about it. Many of our problems are self-made. They are made right here at home, Senator Matsunaga.

Senator **Matsunaga**. I recall in 1979, when I went to Tokyo with President Carter, we had a bill pending here before this committee to set a quota on auto imports from Japan. Japan had been criticized for not allowing American cars to be imported into Japan. So I asked Ambassador Mansfield to arrange for a meeting for me with Japanese officials and auto importers.

At that meeting I asked the Japanese, "Why don't you allow American automobiles into Japan? You go to Washington, you see every other car is a Japanese car. You come here to Tokyo you don't see a single American car on the road." The response I got was from a representative of the Japanese Chamber of Commerce and a representative of the auto dealers. They stated "We have no restrictions on American imports. We have been telling your auto dealers to shift the steering gear from the left to the right because traffic is on the left here. It would be dangerous to drive a left-handed automobile. And we have been asking your auto dealers to make smaller cars for narrower streets in Japan, but they absolutely refuse to do it."

So when I came back I asked Senator Long to hold hearings on this issue. We summoned the auto makers' respresentatives, and I asked the question, "Is it true that you have been asked but have refused to shift the steering gear from left to right and to make smaller cars as requested by the Japanese auto dealers?" The spokesman for the auto makers raplied that it was true. And I asked, "Why? Why don't you?" And he said, "Well, Senator, our market is not in Japan, our market is here in the United States."

If that be the attitude, then the auto industry has failed to produce products which foreigners will buy.

I have exceeded my seven minutes. Did you have something, Senator Chafee?

Senator **Chafee**. I think Senator Rockefeller is ahead of me.

Senator **Rockefeller**. I have only one comment, Mr. Chairman, looking back is easy. We have been talking a lot about telecommunications here. It strikes me as interesting that during the process of deregulation, we did that as a matter of national public policy. We deregulated telecommunications as an industry. But there was never any thought given at any level as to what the policies of other countries might be in their hopes to take advantage of that deregulation. We deregulated. We opened the market. Everybody had a free shot. And nary a thought about the implications in terms of other countries and their policies.

I suppose that that is one of the things that concerns you the most, that type of public policy.

Mr. **Strauss**. That's right. That is exactly right, Senator.

Senator **Rockefeller**. I simply note that, Mr. Chairman.

Mr. **Strauss**. I would bet you that the number of hours spent in the United States Government on discussion of the subject you just raised would fit comfortably under your eyelid.

Senator **Rockefeller**. One more thought, too, with the chairman's indulgence.

There is a philosophy in this country that if the consumer ends up paying a buck less for a product, then somehow it's appropriate national policy because it reflects where the system sorts itself out, and that's fair.

Consumers are also workers. And as we have watched 9 million jobs added on in our economy, we have seen that 60 percent of those now pay $7,000 or less per year, and we have watched over the last six or seven or eight years some 11 or 12 million jobs go. A lot of those are manufacturing jobs. Is it possible any more to assume that national policy on trade is necessarily accurate if the consumer is saving a dollar?

Mr. **Strauss**. I think that we live by what we thought was a 100 percent pure doctrine that the American consumers are entitled to shop among the products of the world for the best possible product at the lowest possible price. And when he or she has that opportunity then the system is working perfectly.

I would say to you that in a perfect world that is true. In this imperfect world, I am not sure that that isn't a doctrine that may be a luxury overall that good public policy cannot afford.

Senator **Rockefeller**. Thank you, sir.

Senator **Matsunaga**. Senator Chafee.

Senator **Chafee**. Thank you, Mr. Chairman.

Mr. Strauss, what expectations are there to open up sectors in the European community and in Japan that have been traditionally heavily regulated by the government or the government is deeply into the ownership? I am thinking of banking and insurance. What I am thinking about is they have a free hand. They come over here. They buy banks. They buy insurance companies, and yet the reciprosity does clearly not exist. Now is there any chance in the world of muscling in there?

Mr. **Strauss**. No, sir. Interestingly, Senator Chafee, I think you picked on two very fascinating entities there, or industries there, insurance and banking. Politically it can be done. And I think we have made some progress and we can make great progress in that area.

The Japanese are opening up bit by bit, and I think we're going to increase in the intensity or increase the—intensity is a bad choice for a term—but I think they're going to increase the rate at which they are opening up in the finance area.

You have Sumatoma just coming over here and making his major investment in Goldman Sacks, you will recall. And in connection with that, I think the Federal Reserve negotiated some additional things, as did the Treasury Department, got some additional concessions out of the Japanese. And there are other areas like that.

No, I think there can be some progress made there, very definitely. And, frankly, I think this whole services sector is something—you know, there is a nutty figure out that says that 70 percent of the jobs in this country relate to the service sector now and something like that equal amount of the GNP. Now that's taking it in the broadest aspects, of course. But this services sector is something this committee ought to really focus on because that gets you into insurance and banking. And progress can be made there. And trying to make it there as opposed to grinding down some of these other areas—agriculture getting into that—it can come much faster.

Senator CHAFEE. You have touched on an area that in the course of your testimony the Japanese, with West Germans, should be spendinp more in the public sector. And I find us in a congruous position when we find our Secretary of Treasury heckling the Japanese or the West Germans that you ought to be spending more of your own money on public works within your nation. And, to me, the Germans, they, as you know so well from your experience in the stage of history, they are extremely aware of any inflationary moves. And if they choose not to spend their money on public works, isn't that their business? I mean, what right in the wildest sense of our imaginations do we have to go over and lecture them on where they should spend their money in order to correct problems that we have created?

Mr. STRAUSS. I find it an uncomfortable situation. But let me respond if I can this way. To begin with, we are not just confining it to public works. We are talking about stimulating the economy a bit. And you will recall that I said I am not talking about wild inflationary stimulation. I am just talking about responsible growth. Now you may say it is kind of hard to turn it on like water out of a faucet with quite that much control. But I also think that we have been the engine of growth in this world since World War II, and I do think we can say, fellows, we are out of gas, and you have got to pick up that engine and carry it on to the next benchmark and give us a breathing spell and a rest, and let us regather some economic strength here for your own sake, because if you don't do that, and our economic situation continues to deteriorate, it is going to destroy the German export situation, and you, as a nation, Germany, have something selfishly to gain by letting us get a breathing spell and helping the third world.

So I think you could cast it in a bit better light than I have written on it in the past and that you just did with that question.

Senator CHAFEE. Let me ask you another question. We have seen studies that indicate that if you eliminated, if it were possible to eliminate all the non-tariff trade barriers of Japan and Western Europe, wherever it might be, that our trade deficit wouldn't significantly change. It would change, but not in a dramatic way. And thus it seems to me we move into the whole area of competitiveness, increasing the United States' competitiveness. And much of the effort in competitiveness is long range. Clearly, we should improve the education of the American people. Clearly, we should encourage technological education. We should do something about R&D. Better help for our people. But most of those are rather long range.

The immediate thing is, of course, the elimination of the deficit which you place number one. But forget the Administration. Congress has shown an incredible reluctance to do anything about that deficit.

Now have you given any thought to changes in other areas that might help that aren't necessarily trade? For example, changes in our antitrust laws that would be based upon not what is the competitive situation in the U.S. but the competitive situation, bringing in the consideration, the foreign competitor.

What would be the harm if Caterpillar bought up all the U.S. competitors, realizing that Kamatsi was outside as the biggest competitor of all? Have you given any thought to that approach?

Mr. **Strauss**. As a matter of fact, Senator, that Young Commission came out with——

Senator **Chafee**. Has a specific on this matter.

Mr. **Strauss**. A very specific, and that was a good report. And I haven't read it in a long time, to refresh my memory, but that was about as good a starting place as we could have. And anyone on this committee that hasn't read and looked over that report ought to do so. It is a pretty first-rate work.

Senator **Chafee**. Now do you support that antitrust provision?

Mr. **Strauss**. I think I would support, maybe not to the extreme extent that you have just described, let somebody buy it all up, but I certainly—we certainly have to take into account the world has changed and we haven't changed with it. The competitive situation today is not Macys and Gimbels as it was in years past. It is coming from Howards in London who are advertising. And the whole world has changed.

Senator **Chafee**. Have you given any thought to the Foreign Corrupt Practices Act and that effect on our competitive position?

Mr. **Strauss**. No, sir, I really haven't.

Senator **Chafee**. I see.

Mr. **Strauss**. But I did in years past. And if we had some changes, a few changes a few years ago that were constructive in that, I think that it improved it.

Senator **Chafee**. Thank you. Thank you, Mr. Chairman.

Senator **Matsunaga**. Thank you, Mr. Ambassador. We hadn't intended to keep you beyond 12:30. You have worked overtime.

Mr. **Strauss**. I am very flattered.

Senator **Matsunaga**. I wish to thank you on behalf of the committee. I think we learned a lot.

Mr. **Strauss**. And you taught a lot, and I thank you.

Senator **Matsunaga**. We agree with you in many respects.

Mr. **Strauss**. Thank you.

Senator **Matsunaga**. Thank you very much.

Mr. **Strauss**. It's a great privilege to be here.

Senator **Matsunaga**. Thank you.

Next Thursday, we will have as our witnesses Mr. John Young, the President of Hewlett-Packard, and of the Young Commission and Mr. Edmund T. Pratt, Jr., chairman and chief executive officer of Pfizer, Inc. and chairman of the Emergency Committee for American Trade [ECAT].

The committee stands in adjournment.

[Whereupon, at 12:43 p.m., the hearing was concluded.]

[The prepared written statement of Mr. Strauss follows:]

TESTIMONY

BY

ROBERT S. STRAUSS

BEFORE

SENATE COMMITTEE ON FINANCE

Tuesday, January 13, 1987

Mr. Chairman and Members of the Committee:

It was ten years ago that I appeared before this Committee, with little experience in the trade field, to be confirmed as Special Trade Representative and it was a proud moment. I am equally proud to be invited back as the lead-off witness to talk about the problems our country faces in international trade and the problems of the world economy in general.

This morning I would like to renew and strengthen a disclaimer I made on that prior occasion: after ten years of rather broad experience I still have no simple over-the-counter remedies to our various economic ailments. Today, however, I do have some ideas and some suggestions that I want to share with you, and that I hope will help put the subject of trade policy in some perspective.

First, I do believe we need a new trade policy for the United States and, accordingly, I strongly endorse this initiative by the Committee.

Many that you will hear from know more about the specific, substantive issues that you are considering than I. My special expertise -- if I have one -- is in the field of political process. If our political process can be made to function effectively -- between Congress and the Executive Branch, between the political parties, and between the Government and the private sector -- then our nation will more successfully grapple with the problems we are encountering in international trade and with the forces that are eroding our competitive position in the world economy. Tough choices must be made, compromises struck, and bitter medicine swallowed. Above all, the Congress and the Executive Branch must work together to devise a common program and then speak with a common voice. A political consensus must be formed to support your efforts and the eventual work product, or it cannot be implemented and sustained.

Your remarks, Mr. Chairman, and those of your colleagues on your desire for a bipartisan Congressional effort are positive and encouraging. So is the indication from Secretary Baker that the Administration wants to be a cooperative player. Furthermore, the Administration is to be heartily commended on its efforts to launch the Uruguay Round. But multilateral negotiations alone cannot solve all of our trade problems.

I am aware that some are skeptical about the necessity or desirability of passing trade legislation in 1987. Some believe the President already possesses all of the legal authority he requires to act. Others are properly concerned about protectionism.

These skeptics, in my opinion, do not fully appreciate the American political process. It is in the process of devising legislation that the Congress and the Executive Branch, in consultation with the private sector, will find and articulate a coherent trade policy for the United States. The process of legislating will focus attention on trade and impose a time-frame in which a consensus must be reached. It is critical that this Committee objectively and unemotionally, putting aside individual, narrow, parochial interests, define the problems we face, examine the root causes of those problems and stake out a course for what we have to do to begin to solve them. While attacking trade barriers and unfair trading practices is vital, the Committee must not forget that the principal culprits are an economic policy that has produced unbelievable budget deficits, a dollar out of balance with other currencies, soaring consumer debt and productivity and competitiveness reaching new lows.

In order to think clearly and constructively about these issues, I find it helpful to keep certain core concepts in mind and to distinguish one from another:

> °There are trade policy problems which afflict producers and consumers in the United States and other countries and which are rapidly eroding the international trading system. Examples abound in the fields of agriculture, telecommunications, intellectual property rights and elsewhere. We must attack these problems aggressively because they adversely affect producer interests in our country and, in turn, our overall economic welfare. But we should not delude ourselves into believing that these trade policy problems are the sole or even major cause of our trade deficit or that they are the major drag on our economy. They are not.
>
> °Separate and apart from these trade policy problems, there are economic problems facing our nation and the world which demand our attention. It is these economic problems which greatly impact the trade performance of our country. These economic problems were created largely by macroeconomic policies which must be dealt with. There are no quick fixes for these problems. It took years of bad economic policies to create them; it will require some time to undo them.

Let me give you some examples to illustrate the distinction I am drawing: The European Economic Community still maintains a monument to protectionist folly known as the Common Agricultural Policy ("CAP"). The CAP costs approximately $27 billion a year to maintain. Part of the waste is borne by European taxpayers and consumers, but a large part of the cost is shifted onto agricultural producers in other countries, most significantly in the midwestern United States. This is the preeminent example of a trade policy problem which must be eliminated through negotiation. Our domestic agricultural problems, which cause so many hardships and eat up tremendous sums of our taxpayers' money, can really only be solved in an international context.

Another example of a trade policy problem can be found in the field of telecommunications. The United States has unilaterally opened its telecommunications markets to imports from other countries without demanding that other countries similarly open their closed telecommunications markets to our exports as well. This, too, is a trade policy problem which cries out for attention.

As serious as these and many other trade policy problems are, and they are deadly serious, they should not divert our attention from other serious problems which are impairing our competitive position and weakening the world economy as a whole.

It is easy -- often too easy -- to blame all our trade problems on foreigners, all nations do that. Foreigners don't vote. But it is now time to begin asking ourselves some tough questions about the performance of the U.S. economy. Why is it, for example, that U.S. productivity growth lags far behind those of our principal competitors and has done so for many years? In the 1960's, our productivity grew at a rate that doubled our standard of living every 23 years. At today's rate of growth, it will require 70 years.

Why is it that in the U.S., expenditures for research and development, investment in new plant and equipment, and other critical signs of economic vitality are lagging compared with other countries? What are we going to do about our budget deficits? Why aren't we, at least, leveling with the American people about the implications and attempting to get their political support to address these problems? We cannot begin to address our country's trade problems in a meaningful way unless we begin to come up with answers to these and other troubling questions.

At the same time, we must direct our attention to the serious problems of the global economy, including Third World debt, which are preventing these economies from growing and importing our products. We must also examine the reasons for slow growth in the industrial countries. After World War II, we spent our resources supporting others. Now, the capital exporting countries should be called on to increase their assistance to the Third World. Without dwelling further on specifics, leaders in both government and the private sector must come to appreciate more fully the rapid internationalization of markets and the consequences of this for national policy and private business decisions.

As I conclude, I hope it is not presumptuous to draw some lessons I've learned from my experience in the public and private sectors.

Number One: Partisan trade policy is bad trade policy. I've talked of forging a political consensus. As STR, I worked particularly closely with Chairman Long, Abe Ribicoff, and with you, Mr. Chairman, and others on your side. But I can never forget how important the strong support of Bob Dole, Bill Roth, Jack Danforth, John Heinz and others on the Republican side was to our efforts. It was bipartisan support that was essential to the drafting and passage of the 1979 Trade Act almost unanimously in the House and Senate.

Number Two: The Executive Branch must speak with one voice on trade policy. We need a trade policy for America -- not a trade policy for Treasury, Commerce, State, STR or Defense. Trade problems must receive the personal attention of the President and his White House advisors. I can't emphasize this point enough. No foreign nation will take our trade negotiations and policies seriously unless they believe that the President is personally involved in the process. Ministers can only nibble around the edges of the problems.

Number Three: Neither the Congress nor the Executive Branch can make good trade policy on their own. They must work together.

Number Four: Trade policy cannot be separated from domestic economic policy. The greatest single problem behind our trade deficit is our budget deficit. An overvalued dollar has priced us out of key markets and has made imports appealing to our consumers.

Lesson Number Five: The search for new ideas in the trade policy arena is not a substitute for effective action. Over the past few years, members of Congress, business leaders, think tanks of all political persuasions, and academics have been working to explain our trade problem and develop new solutions. However, the search for new ideas, while worthwhile, has become an end in itself. We must no longer postpone action. We must reduce the deficit, deal with Third World debt in a sensible fashion, crack down on unfair trade practices, and coordinate trade policy within the Executive Branch, possibly with a new Trade Department. I have long opposed a new Trade Department, as have many of you, but maybe it's an idea whose time has come. At any rate, it should be examined and accepted or rejected for the right reasons, not to satisfy narrow bureaucratic interests. It's not a substitute for substantive action, but if done in the proper way, could help us develop and execute trade policy.

Number Six: Government cannot develop effective trade policies in isolation -- business, agriculture and labor must be deeply involved in the policy process in a collaborative fashion. In 1974, this Committee established a private sector advisory system to ensure that private sector input was fully considered in formulating trade policy. This system, in my opinion, has recently been neglected and should be restored.

Number Seven: Trade today, as when the nation was founded, is a commercial process based on reciprocal treatment. It must be fair or it cannot work. We have exercised world leadership by keeping our markets open and our investment climate unrestricted. Other nations have not always reciprocated. Now the message should go forth from your deliberations that those who wish to sell their goods and offer their services in our markets must extend similar treatment to us. To say it more dramatically, those whose ships loaded with products enter our harbors must make room for our ships in theirs.

Finally, Mr. Chairman, there is the question of Japan. The U.S. cannot deal with its trade problems without confronting the issues posed by our $54.6 billion trade deficit with that country. There is no one solution to the complex set of economic and cultural factors which have created this massive bilateral trade deficit. However, we are now mired in a sector by sector approach that has produced meager results. The time has now come to elevate this issue to the highest political level. We should convene a fully prepared U.S.-Japan economic summit -- not a series of photo opportunities -- but a real negotiation where both parties attend, fully prepared to put meaningful bargaining chips on the table in an effort to achieve substantive results. This summit should take place within the next six months and be structured with ample opportunity for Congressional participation.

Mr. Chairman, the issues before you are immense in their implications. Freedom around the world depends on the strength of the United States and our strength depends on our maintaining a strong and balanced economy.

It is my firm conviction that if we raise U.S. trade policy to the same status as defense, and if we form a political consensus on trade, we can, within five years, reach new economic horizons for America that will enrich the economic lives of our citizens and make the world a safer place to live. With great sincerity and without hyperbole, I say to you that you can lead the nation in an historic step forward.

MASTERING THE WORLD ECONOMY

THURSDAY, JANUARY 15, 1987

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to notice, at 9:30 a.m. in room SD-215, Dirksen Senate Office Building, the Honorable Lloyd Bentsen (chairman) presiding.

Present: Senators Bentsen, Matsunaga, Baucus, Mitchell, Pryor, Riegle, Rockefeller, Daschle, Packwood, Danforth, Heinz, Durenberger, and Armstrong.

[The prepared written statements of Senators Heinz and Durenberger follow:]

STATEMENT OF SENATOR JOHN HEINZ

This is the second in the Committee's series of hearings looking at the world trade picture and America's problems within the international system. Today's discussion will focus on competitiveness, and the Committee is fortunate to have both Ed Pratt, chief executive officer of Pfizer as well as chairman of the Emergency Committee for American Trade and former chairman of the Advisory Committee on Trade Negotiations, and John Young of Hewlett-Packard and chairman of the President's Commission on Industrial Competitiveness with us as witnesses.

Competitiveness means many things to many people. I hope that during this hearing we can establish some consensus on what it means, how much of what it means is within this Committee's jurisdiction, and what we can do to enhance competitiveness as a result of government initiatives.

In my own work on the subject, I have focused on three broad areas; maximizing the potential of our human resources with considerable attention to adjustment assistance and dislocated workers; trade barriers—both those of others and those we impose on ourselves; and capital formation, which is of critical priority for business start-ups, telecommunication and high technology sectors, and manufacturing generally. Of course, the issue of competitiveness encompasses still more, and I hope we will be able to further flesh it and our agenda for action out at today's hearing.

STATEMENT OF SENATOR DAVID DURENBERGER

Mr. Chairman, I want to take this opportunity to commend you for holding this set of hearings on the long-term goals of American trade policy. These hearings come at a crucial juncture in our history. For the second consecutive year, our trade deficit will set a record. More ominous is the fact that in three short years, we have moved from being the world's largest creditor nation to being the world's most indebted nation.

Although in 1986 the dollar declined significantly against the currencies of most our major trading partners, our trade imbalance with the rest of the world continued to expand at an alarming rate. The result of this imbalance in trade has led many to call for protectionist solutions that will only guarantee retaliation from abroad, worldwide economic stagnation, and a decline in our standard of living.

Economic relations with our allies, especially the Japanese and the European Community, are at their lowest point in 50 years. And trade and debt tensions with our neighbors in this hemisphere threaten political instability in Latin America and an agricultural trade war with Canada.

Mr. Chairman, there are no easy solutions to the multiplicity of trade problems confronting our nation. Our highly productive farmers are being shut out of world markets partially because of subsidy policies adopted by the European Community, and partially as a result of fiere competition from Latin America countries who are forced to earn foreign currency to pay off their debts to Western banks.

Resolution of the agricultural trade crisis can only occur through government-to-government negotiations, such as those which took place recently in Uruguay under the auspices of the General Agreement on Tariffs and Trade (GATT). But the agricultural crisis will not dissipate until American, European and Japanese bankers agree on a rational formula for rescheduling and writing down the massive foreign debts of Latin America.

The steady erosion of our industrial base and the recent decline of our high tech industries raises issues both of national security as well as the future economic competitiveness of our society. Why are we losing our supremacy in semi-conductor manufacturing to the Japanese? Why have the Japanese and European machine tool industries succeeded in endangering the viability of our domestic industry? Why have the Japanese taken over the consumer electronics market and been able to claim more than 25 percent of domestic auto sales? Why has our steel industry been able to barely survive only with the assistance of government programs limiting imports of foreign steel?

If we are to find truly meaningful answers and solutions to these questions, I believe we must give serious consideration to two issues: (1) Can American business effectively compete in a global market bearing the weight of the social responsibilities and cost mandated by the Federal government? and (2) Does the American corporation's focus on short-term profitability inevitably doom it into extinction when facing foreign competitors who have a long-range competitive vision.

In the past 20 years we in the Congress have legislated much of our social vision onto corporate America, and along with that vision there is a cost which does not enhance competitiveness nor productivity. For example, we have required American corporations to bear the costs of occupational safety laws, environmental laws, and uniform pension and health laws. I voted for nearly all of these laws because I believe that we as a nation should set a quality-of-life standard to which all other countries can look up to.

Yet by imposing these standards, we have diverted capital from what some might call "productive investments," and, in the process, hampered the ability of American business to compete in the world market. Can we continue to afford to impose similar social mandates on business and expect it to compete? I hope we find out the answer to that question in the coming months.

Much has been written about the short-term quarterly profit mentality of American business. I'm not convinced that keeping a close watch on short-term profits is inherently bad. Yet, the constant pressure that quarterly reporting puts on management makes it extremely difficult for American companies to gain footholds in new markets, and instead encourages companies to close marginally profitable divisions that in 3 to 5 years could become important sources of profits and jobs.

Mr. Chairman, after our experience last year in crafting a tax reform bill, I have little doubt but that this committee will gather a bipartisan concensus and write a responsible non-protectionist trade bill. But let us have no illusions that we in this Committee or in Congress can immediately revitalize American industry and agriculture and eliminate the trade deficit overnight. There are many hard questions to answer. I look forward to working with the Chairman in finding solutions to these challenges.

The CHAIRMAN. It is 9:30, and the committee will come to order and we will start the proceedings.

The first thing that we have to consider this morning is a resolution concerning the budget expenditures of the committee itself, and we will wait for final action on that until we have a quorum present. But to report to the committee on the amount of money that we are requesting, we are requesting the identical budget of last year, which includes the supplemental $235,000 that was approved on the floor of the Senate, with a 3 percent adjustment to salary that started as of January the 1st for cost of living.

The total amount involved will be $2,455,654. Now if the committee members have any questions concerning that, we have staff here to reply in detail on any one of those points.

Senator PACKWOOD. Mr. Chairman.

The CHAIRMAN. Yes, Senator Packwood.

Senator PACKWOOD. I am delighted to have been able to hold the supplemental amount we got last year. As you will recall, we made that request because we knew we were going to have the tax battle. Thank heavens we had it, as we indeed did. But as I indicated at our hearings on Tuesday, I think the trade issue is going to be as big an issue as the tax issue, and you are going to need it. And I fully endorse the budget that the chairman has presented.

The CHAIRMAN. Thank you.

Senator Baucus.

Senator BAUCUS. No questions.

The CHAIRMAN. Senator Rockefeller?

Senator ROCKEFELLER. No questions.

The CHAIRMAN. Well, we will continue on that and ask for the action of the committee when a quorum is present. Thank you very much.

We are very fortunate to have as our first witness this morning, Mr. John Young, who is the chairman and chief executive of Hewlett-Packard. He was also the chairman of the President's Commission on Industrial Competitiveness, and devoted a great deal of his time, made quite a contribution of effort, to coming up with what I thought was a very comprehensive, very productive report. Unfortunately, Mr. Young, I don't think enough of it has been implemented. But we have you here now to discuss a subject which we think is a paramount concern and problem facing our nation today.

It was estimated that last year we would have a $173 billion trade deficit. There is no way that this nation can continue to have that kind of a drain on its resources without ultimately having a lowering of the standard of living of the people of this country.

We are trying to find a consensus for a trade bill that will help turn that around. And obviously the business community plays a major role in that, since you are out on the front lines of that fight.

We do not anticipate that any legislation that we pass is going to be a quick fix, total answer to the problem. We understand there are many facets to those concerns that have to be addressed. Some of those will be beyond the legislative realm, and we will be considering the question of priorities, too: What priority we should give to trade, as compared to other concerns of the country? What kind of leadership is going to be exercised by the Administration in this regard? What American business does to try to confront and meet the problem and what American labor does in cooperation with that.

We are also pleased to have with us this morning Mr. Edmund Pratt, who is the chairman and chief executive officer of Pfizer, which is one of the largest pharmaceutical companies in the world, an international company that has been out on the cutting edge of technology, who has filled many roles in a pro bono capacity in trying to find some solutions to some of these problems.

He is chairman of the Emergency Committee for American Trade, and that is a trade association of some of the largest U.S.-based multinationals.

So we welcome each of you this morning. Mr. Young, if you would proceed. And then we will follow with Mr. Pratt. And I would urge my colleagues when we come to the questions to limit their questions to five minutes as we start out this morning.

Mr. YOUNG.

STATEMENT OF MR. JOHN YOUNG, CHIEF EXECUTIVE OFFICER AND PRESIDENT, HEWLETT-PACKARD CO., AND CHAIRMAN, PRESIDENT'S COMMISSION ON INDUSTRIAL COMPETITIVENESS, PALO ALTO, CA

Mr. YOUNG. Mr. Chairman and Senators, thank you for inviting me to join you here this morning. And let me commend you for organizing a very timely and farsighted series of hearings.

I have had the opportunity to give a lot of thought to the subject of trade in recent years, first, because I am the head of a major electronic company that has about half of its business outside of the United States, and we have a mix of exports in foreign investments. In fact, we are the thirteenth largest exporter from the United States.

Second, I have been, as Senator Bentsen said, chairman of the President's Commission on Industrial Competitiveness, which took an in-depth look at the ability of U.S. industry to compete both at home and abroad.

Now I am heading a group of private sector leaders, who will continue the efforts to focus on that issue, and we call that the Council on Competitiveness.

Let me begin by starting with an insight that I think best characterizes my feeling about trade. I think it is something you could think about like a group of people playing chess. We are standing around and deeply involved and deeply involved in the game. We are caught up with the strategy; we are watching each player's moves with a great deal of interest. But we are so absorbed in this game, we don't notice that the location is the foredeck of the Titanic and the waters are rising around us.

I think it is very much the case with trade. And I want to, in my comments at least, try to provide a little bit broader view, at least my perspective, on some fundamental changes in the world economy, in our own economy, and in the way public policy choices shape that competitive environment.

Let me share then some conclusions I have reached on this subject.

First, trade is only part of a very much broader set of issues that affect this nation's ability to compete in world markets. Now I lump these issues under what I call competitiveness, so let me start with a definition.

For this nation, or any nation, competitiveness means the degree to which we can, under open and fair market conditions, produce the goods and services that succeed in the international marketplace while at the same time maintaining or increasing the real income of its citizens.

Now there are many indications of a decline in this country's ability to compete in these world markets.

We have had stagnant real wages since 1973. We have had a productivity growth rate that is surpassed by essentially all of our trading partners. We have had declining rates of return on assets employed in our vital manufacturing sector. And we have had loss of world market share in seven out of 10 of the high technology sector, and, of course, a growing merchandise trade deficit.

But I think it is worth noting that our trade deficits started in the early 1970s, in the period when the dollar was widely thought to be undervalued.

We no longer have the unquestioned or unchallenged economic predominance in the world. Exchange rates have exacerbated, and therefore obscured the weakening of our competitive position.

So if you concur in my definition that competitiveness means the ability to earn a rising standard of living for our people, you will also agree that being competitive is what allows us to attain our other vital national goals, that is, jobs for our people, the social services financed by taxes on personal and corporate incomes, and a strong national security.

What I have said then is that our trade deficit is just a symptom, one symptom, of a weakening of our competitiveness position vis-a-vis our trading partners, an erosion that threatens our ability to attain our other national goals.

Now trade policy is also one of the several factors that determines our competitive position. And a chart that I have attached to your handout will illustrate that point. This schematic was developed by the Commission on Industrial Competitiveness, and I think it summarizes in quite a simple way the factors that determine our competitiveness posture and what we might expect to attain in the way of improvements.

You will note that there are really four basic areas where government plays the lead role: monetary and fiscal policy that affect our exchange rates; U.S. trade policy; and, of course, international policy. These are the public policy areas that create the environment in which American business compete. And trade policy is only a part of the problem government needs to address, and it is only part of the solution. We really cannot solve our competitive problem by just fixing trade policy.

At best, we can achieve parity with our trading partners, that is, achieve an open and fair world market. But parity is something we must reach, and that necessity brings me to my second conclusion, that while trade has grown dramatically in both volume and complexity, the portion of trade covered by the agreed on rules of GATT has actually declined.

Despite a sevenfold increase in the dollar volume of trade in the last decade and a half; despite the fact that imports and exports now comprise more than one-fifth of U.S. manufacturing output, and fully 70 percent of U.S. manufactured goods are fully exposed to international competition; and despite several rounds of talks to expand and strengthen the General Agreement on Tariffs and Trade, today, only 15 percent of trade restrictions are covered by any agreed on rules.

In 1950, fully 40 percent of such barriers were covered. But the simple, post-World War II challenge of reducing high tariffs has given way to a whole new set of problems, such as the fact that the newly industrializing nations, now quite important, have never really bought into the GATT; the changing nature of traded values, such as intangibles like intellectual property and services. And now we have subtle non-tariff barriers such as regulations, standards and investment limitations. And then we have seen new national strategies aimed at creating a comparative advantage in key industrial sectors.

Now we can respond to some of these changes by increasing membership in GATT, expanding its coverage to include such items as intellectual property and services, and by providing it with an ability to exercise multilateral pressure on trade offenders.

It is vital that the U.S. take a leadership role in this new round of GATT talks that will address these issues.

Yet having done all of that, we are not finished. Some of these trade-distorting practices used to create sectoral comparative advantage are so subtle and so deeply enmeshed in national policies that it is unlikely we can ever devise rules that would be sufficiently rigorous and flexible to regulate these activities.

For such cases, we may have to look at the trade flow outcomes to ascertain whether steps should be taken to bring things more in balance. And creating balance is the key. Significant imbalances threaten the health of the world trading system.

Now this discussion of different national strategies brings me to my third conclusion: Trade flows are tightly linked to financial flows. And this, of course, has always been the case, but today the linkage is tighter than ever for two reasons.

First, the post-World War II era of unquestioned U.S. economic predominance has vanished. The competition is global and strong. Technology spreads quickly around the world, product life cycles are shortened, and production facilities are highly mobile.

Because the competition is more in balance, we don't have the cushion or decoupling we used to enjoy, so that factors such as exchange rates and capital costs have a much greater impact than they used to. When we had a significant cost advantage, or a unique technology, such things did not matter so much. Today, they do.

Second, the sheer volume of world financial flows is perhaps 50 times greater than trade flows.

The president of the New York Fed has estimated that on an average day $1 trillion changes hands. And it is interesting to think about the GNP turning over in a couple of days. This is a supranational system run from 100,000 terminals around the world and those unblinking screens leave no place to hide.

Rather than responding to trade flows then, as in classic theory, exchange rates then have indeed shapes trade flows.

It is also worth remembering that as recently at 1981, the U.S. had a current account surplus. But our budget deficit and related policies have created a vacuum that literally sucked in capital and imports from around the world. We created for ourselves a comparative disadvantage.

Taiwan, on the other hand, has created for itself a trade advantage by keeping its currency too low by any reasonable measure, and as a result has a trade surplus with just about every nation in the world, its 21 percent of GNP and $16 billion alone with the U.S.

Now if a company sold its goods at below its domestic market prices it would be considered dumping. There would be appropriate remedies under the GATT. But if a nation as a whole effectively does the same thing by manipulating exchange rates, there is no recourse.

So fiscal and monetary policies, and the capital costs and exchange rates that stem from them, matter very much.

You cannot remedy our trade imbalance without addressing these fundamentals. It is becoming increasingly clear that we need some kind of multilateral adjustment mechanism to avoid the kinds of imbalances we have experienced in recent years.

And this brings me to my fourth and final conclusion: The process of reconciling fiscal, monetary and trade policy on a multilateral basis needs our focused attention.

There is no Adam Smith invisible hand that makes trade flows all balance out smoothly. If trade were only bilateral, imbalances would correct themselves rather quickly. You can stop buying my wool, so I can no longer buy your wine.

But in today's very complex, multilateral trading environment, such self-correction happens too slowly. Balance, of course, will be achieved in the long term, but the duration of the imbalance can be much longer than the ability of individual firms to withstand those effects. In the meantime, firms may lose market share they can never regain, or simply go out of business.

And, of course, the human costs are tremendous. As a recent, very fine study on trade done by Morgan Guaranty Trust Company put it, "Unfortunately, the economists' time lag can turn into the politicians' nightmare."

Mr. Chairman, Senators, you are not the only ones with challenges to address. So far, I have talked about the determinants of competitiveness where government plays the only role: trade, fiscal and monetary policy. Public policies in science, technology and education, of course, also form part of the environment in which we operate.

But I would be remiss if I didn't publicly recognize that the private sector is ultimately responsible for being competitive.

We have the prime responsibility for creating and applying technology, forging a committed workforce, and managing effectively.

We are responsible for the farsightedness of our strategies and the attractiveness of the products we bring to market. And we accept that responsibility.

But let me say this: If we had a current account surplus as recently as 1981, it seems inappropriate to lay today's deficit at the doorstep of American management.

In that short period, business leaders didn't suddenly lose their vision and drive and they haven't made a mass exodus for the golf course.

The environment has changed drastically and government created that environment. We have managed the mix of trade, fiscal and monetary policies in such a way as to create competitive disadvantages for American firms.

The challenge before you then is to articular a world view that includes all of these policy factors, to determine what can and cannot be accomplished through trade policy, and then to be sure that appropriate initiatives are undertaken to address these and other factors that critically determine our performance.

It will be a formidable task. You will undoubtedly hear many narrow and seemingly worthy proposals that could actually be anti-competitive when viewed from the prospective of the broad forces that are at work.

The challenge will be to avoid getting caught in the maneuvers of a chess game while these high waters swirl over the deck. And I know you are trying to avoid just that.

I want to thank you for your willingness to survey the breadth and depth of the ocean before charting our new course on trade.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Young. We will withhold our questions until both witnesses have had an opportunity to testify.

We have scheduled only these two witnesses this morning because we felt the depth of their knowledge on the issue was important to us and we wanted to have a chance to have a full line of questioning and exchange of thought concerning the issue with them.

[The prepared written statement of Mr. Young follows:]

JOHN A. YOUNG

PRESIDENT AND CHIEF EXECUTIVE OFFICER

HEWLETT-PACKARD COMPANY

Mr. Chairman, Senators. Thank you for inviting me to join you this morning at what I believe is a very crucial and farsighted series of hearings.

I've given a lot of throught to the subject of trade in recent years:

-- first, as the head of a major electronics firm that does almost half of its business abroad.

-- second, as chairman of the President's Commission on Industrial Competitiveness, which took an in-depth look at the ability of U.S. industry to compete both at home and abroad;

-- and now as head of a group of private sector leaders who will continue efforts to focus on that issue, the Council on Competitiveness.

I'm not sure whether I've just certified my credentials with you -- or just proved myself as certifiable. But no matter what you may think about my sanity, at least you can be assured that I've given the trade issue some consideration.

Let me begin my sharing an insight that supports the whole purpose of these hearings:

In thinking of trade, we are often like a group of people playing chess -- only the game is being played on the decks of the Titanic.

We stand around, watching each player's move with great interest. And we're so absorbed in the game that we don't even notice that the water's rising all around us.

So it is with trade. That's why my goal today is to provide a broader view of some fundamental changes in the world economy, in our own, and in the way public policy choices shape the competitive environment. Let me share some conclusions:

First, trade is only part of a much broader set of issues that affect this nation's ability to compete in world markets. I lump them under the heading of competitiveness, so let me start with a definition.

For this nation -- as for any nation -- competitiveness means the degree to which we can, under open and fair market conditions, produce goods and services that succeed in international markets while at the same time maintaining or expanding the real income of our citizens.

There are many indications of a decline in this country's ability to compete in world markets:

-- stagnant real wages;

-- productivity growth that's surpassed by almost all our trading partners;

-- declining rates of retun in our vital manufacturing sector;

-- loss of world market share in high-technology sectors;

-- and growing merchandise trade deficits.

And I think it's worth noting that our trade deficits started in the early 1970's, when the dollar was widely thought to be undervalued.

Some economic fundamentals have shifted. Exchange rates have just exacerbated -- and therefore obscured -- the weakening of our competitive position.

If you accept my definition that competitiveness means the ability to earn a rising standard of living for our people, then you'll agree that being competitive is what allows us to attain other vital national goals -- jobs for our people, the social services financed by taxes on personal and corporate incomes, and a strong national security.

All right. I've said that our trade deficit is one symptom of a weakening of our competitive position vis a vis our trading partners, an erosion that threatens our ability to attain other national goals.

Trade policy is also one of several factors that determine our competitive position -- perhaps not even the most important. The chart attached to your handout will illustrate my point.

This schematic was developed by the Commission on Industrial Competitiveness, and I think it summarizes in a simple way the factors that determine our competitive posture and what we might expect to attain in the way of improvements.

You'll note that there are four basic areas where government plays the lead role -- capital costs, exchange rates, U.S. trade policy and international trade policy. These are areas where public policy creates the environment in which American business competes.

Trade policy is only part of the problem government needs to address. And it is only part of the solution. We can't solve our competitive problems by fixing trade policy. At best, we can achieve parity with our trading partners -- that is, open and fair world markets.

But parity is someting we must reach, and that necessity bring me to my second conclusion: While trade has grown dramatically in both volume and complexity, the portion of it covered by agreed-upon rules has actually declined.

Despite a sevenfold increase in the dollar volume of trade in the last decade and a half;

-- despite the fact that imports and exports both now comprise more than one-fifth U.S. manufacturing output;

-- despite several rounds of talks to expand and strengthen the the General Agreement on Tariffs and Trade;

today, only 15 percent of trade restrictions are covered by any agreed-upon rules.

In 1950, fully 40 percent of such barriers were covered. But the simple, post-World War II challenge of reducing high tariffs has given way to a whole new set of problems:

-- newly industrializing nations that never really "bought into" the GATT:

-- the changing nature of traded values, such as intangibles like intellectual property and services;

-- subtle non-tariff barriers such as regulations, standards and investment limitations;

-- and new national strategies aimed at creating comparative advantages in key industrial sectors.

We can respond to some of these changes by increasing membership in GATT, expanding its coverage to include such items as intellectual property and services, and by providing it with the ability to exercise multilateral pressure on trade offenders. It is vital that the U.S. take a leadership role in the new round of GATT talks that will address these issues.

Yet having done all that, we're not finished. Some of the trade-distorting practices used to create sectoral comparative advantage are so subtle and so deeply immeshed in national policies that it would be impossible to ever devise rules that would be sufficiently rigorous and flexible to regulate these activities.

For such cases, we may have to look at the trade flow outcomes to ascertain whether steps should be taken to bring things more in balance. And creating balance is key. Significant imbalances are untenable. A healthy world trading system benefits everyone, everywhere.

This discussion of different national strategies brings me to my third conclusion: Trade flows are tightly linked to financial flows.

This has always been the case, but today the linkage is tighter than ever, for two reasons. First, the post-World War II era of unquestioned U.S. economic predominence has vanished.

The competition is global and strong. Technology spreads quickly around the world. Product life cycles have shortened. Production facilities are highly mobile.

Because the competition is more balance, we don't have the cushion or margin of error we used to enjoy. Factors such as exchange rates and capital costs have a much greater impact than they used to. When we had a significant cost advantage -- or a unique technology -- such things didn't matter so much. Today, they do.

Second, the sheer volume of world financial flows is perhaps 50 times greater than trade flows. Rather than being affected by trade flows -- as in classic theory -- exchange rates instead have shaped trade flows.

It's worth remembering that as recently as 1981, the U.S. had a current account surplus. But our budget deficit created a vacuum that literally sucked in capital and imports from around the world. We created ourselves a comparative disadvantage.

Taiwan, on the other hand, has created itself a a trade advantage by keeping its currency too low by any reasonable measure -- and as a result has a trade surplus with just about every nation in the world.

If a company sold its goods at below its domestic market prices, that would be considered dumping. And there would be a remedy under GATT.

But if a nation as a whole does the same thing by manipulating exchange rates, there is no recourse.

So fiscal and monetary policies -- and the capital costs and exchanges rates that stem from them -- matter very much.

You can't remedy our trade imbalance without addressing these fundamentals. It's becoming increasingly clear that we need some kind of multilateral adjustment mechanism to avoid the kinds of imbalances we've experienced in recent years.

This brings me to my fourth and final conclusion: The process of reconciling fiscal, monetary and trade policy on a multilateral basis needs our focused attention.

There is no Adam Smith invisible hand that makes trade flows all balance out smoothly. If trade were only bi-lateral, imbalances would correct themselves rather quickly. You stop buying my wool, so I can no longer buy your wine.

But in today's very complex, multilateral trading environment, such self-correction happens too slowly. Balance will be achieved in the long term, but the duration of the imbalance can be longer than the ability of individual firms to withstand their effects. In the meanwhile, firms may lose market share that they can never regain, or just go out of business.

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The environment changed drastically, and government created that environment. We have managed the mix of trade, fiscal and monetary policies in such a way as to create competitive disadvantages for American firms.

The challenge before you, then, is to articulate a world view that includes all these policy factors, to determine what can and cannot be accomplished through trade policy, and then to be sure that appropriate initiatives are undertaken to address these other factors that determine our performance.

It will be a formidable task. You will undoubtedly hear many narrow but semingly worthy proposals that could actually be anti-competitive when viewed from the perspective of the broad forces that are at work.

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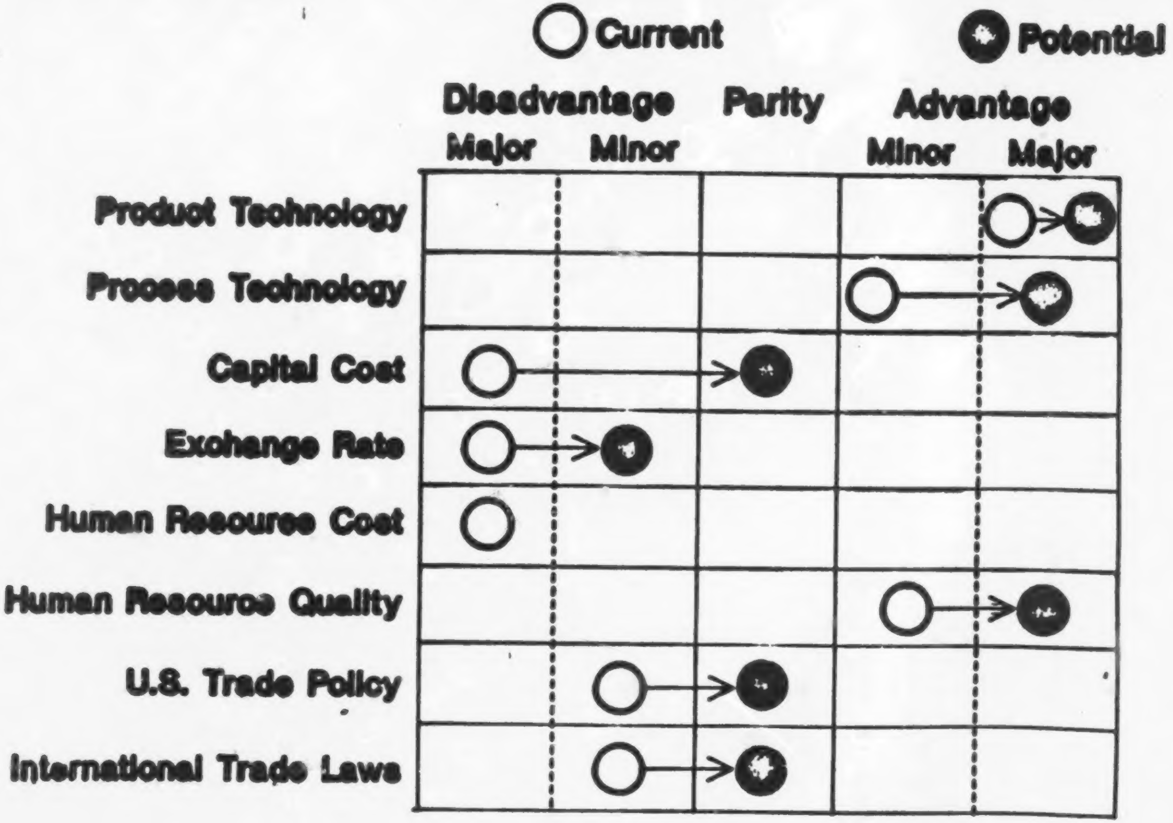

Competitive Profile, U.S. Leverage Points

The CHAIRMAN. Our next witness is Mr. Pratt, who I have previously introduced. We are very pleased to have you. If you would proceed, please.

STATEMENT OF MR. EDMUND T. PRATT, JR., CHAIRMAN AND CHIEF EXECUTIVE OFFICER, PFIZER, INC., AND CHAIRMAN, EMERGENCY COMMITTEE FOR AMERICAN TRADE

Mr. PRATT. Thank you, Mr. Chairman. I also join John in expressing our appreciation for having an opportunity to be with you this morning on this critical issue. If I might prevail upon you, I would like to make a few ad hoc comments that aren't in my text.

We in the business community are concerned about the seriousness of the issue of the dual budget and trade deficits. I kept waking up last night as I was thinking about these issues, and running over and jotting down additional things that I thought were important to say to you.

Let me first say that I think it is a helpful thing from your point of view that the great majority of the business community sees more or less eye to eye on most of these issues that are before you. My thoughts closely match those that John Young has already given. While there will be some overlap, we will try to avoid as much of that as possible.

ECAT, that I am representing, consists of about 60 major companies in American industry who, together, comprise a great deal, a high percentage, of the total economic structure of our nation.

ECAT is 20 years old this year. It was created because of the rustlings of protectionism in our nation after the war. ECAT has been testifying these last 20 or 22 years, bringing to your debates and considerations in government that side of the issue which we represent, which is that of concern with the negative effects that protectionists' steps would have on our member firms.

And so our testimony over the years has been strongly "free trade" oriented, hoping to remind you that there are several sides to this issue. And in many respect we remain that way, although the situation is certainly quite different. The number of business firms that are experiencing difficulty with import competition are quite larger than they were 20 years ago and ECAT's thrust has changed somewhat.

Business, as I said, is terribly concerned about the trade issue. And I think if I can say one thing that we believe—there are so many aspects to it; it is hard to come to grips with it, obviously, or we would have done it before this—the one thing that I suspect that is most important that we could say to you is that it is absolutely critical that the nation, the government, put trade and its related aspects at a higher level of priority than we have in the past. Foreign trade has tended to play second or third fiddle to other issues at a time when perhaps we could afford that. Since it has now become probably the overwhelming problem that we have, we can no longer have that luxury.

I would also like to say that to fully understand the problem you really have to be careful about just using the word "trade". In fact, I try never to use the word "trade" any more. We should talk about international business, international commercial relationships, some other word that better describes it, because a tremendous percentage of our international activity and our profits from it come from other than pure trade, from investment abroad. And that poses a whole new series of problems for us, like investment rules and intellectual property rights protection, and so forth. So it is a broader issue now than just trade.

I was interested in the title of today's hearing, "Mastering the World Economy." I read the article that that term, I guess, came out of, and I can't help mention in passing that if you look at the success of the American multinational companies in the world markets you see quite a different picture than you do about our trade balance, per se. Indeed, the American multinational companies have been out trying to master the world economy for the last 30 or 40 years, and with a fairly sizeable degree of success. I think within that lies part of the solution to the problems we face, and it ties into the fact that we are not just talking about trade, but international business.

In the light of many decades of American economic leadership, it is difficult and often painful to recognize that the United States is no longer the dominant world producer of many industrial and agricultural goods. Such recognition is rapidly being forced upon us as we witness the effects of foreign competition, both in our own and in foreign markets.

It is critically important that we, as businessmen, and as government leaders, respond to rapidly changing economic events in ways that will allow us to continue our world leadership in what is an increasingly integrated world economy.

Without the effective leadership of the United States during the last 40 years, the world would certainly be a very different place. I would guess it would be very likely a much poorer world with considerably less international trade and investment.

I can tell you from my own experience as a member of the U.S. Delegation to the GATT meetings in 1982 in Geneva, and in 1986 at Punte del Este that without U.S. leadership, the GATT would be a more moribund organization. And that would be a shame for the United States and its trading partners, whether or not you are satisfied with the GATT's progress.

Without U.S. leadership over the years, tariffs among the industrialized countries would be expected to be perhaps in the 25 to 50 percent range rather than at the present 5 to 10 percent. The trade impact of such tariffs would have resulted in much lower employment and living standards around the world.

Imaginative U.S. leadership is now sorely needed to help guide the countries of the free world through the economic uncertainties facing all of us. What is needed is U.S. agreement on a domestic and international framework through which an open international trading system can be sustained.

From the perspective of a businessman, such a framework above all calls for U.S. actions that will effectively reduce the federal budget deficit to proportions that will enable domestic savings to equal or exceed investment so that we will no longer be a net international debtor.

This would be the single most important action that the government could take as a corrective to the foreign trade deficit. Its effect on the exchange rate of the dollar would be positive and it would go a long way toward improving the U.S. balance of trade and the current account.

Indeed, in my judgment, the foreign trade deficit is directly related to the federal budget deficit. It is difficult to conceive of a solution to the trade deficit without a solution to the budget deficit.

This framework that we need to create also involves a number of actions that should be undertaken by other nations and cooperative actions that should be undertaken by all, and we have been working on these, I know. Divergent macroeconomic policies need to be better coordinated among nations.

In the interests of maintaining a workable international economic system, Japan, for example, should not only more effectively open its markets to imports and foreign investments but also should take domestic steps to encourage investment and production for domestic consumption as a means of reducing Japan's excessive reliance on production for export markets.

Fairly recent steps initiated between the United States and others in the areas of international monetary and financial cooperation and coordination that were, of course, critical are most welcome. They are a recognition that economic progress can best be achieved through international cooperation and not through unilateral actions that are at the expense of others.

There are a number of matters in addition to monetary and financial issues that should be resolved internationally. Certainly one of the key one of these are the trade, or investment, foreign business issues. And I would like to talk a little about some of them in the time remaining.

First, I would like to say there truly is in place a world economy. While its component parts are the economies of the individual nation-states, the parts are increasingly being bound to each other through modern communications and transportation technologies. International trade, financial and investment flows are growing faster than is world production. Production itself is increasingly international in scope.

Growing economic interdependence is a fact of life. It cannot and should not be wished away for it makes possible greater economic efficiencies worldwide with consequent increases in living standards.

At the same time it creates new uncertainties and it provides constraints on individual nations in managing their own economies. These constraints are often frustrating and sometimes painful. They, for example, impact upon wage rates and other costs of production, and thus cause anger and sometimes lead to requests for protection from overseas competition.

Fortunately, we have domestic trade statutes that are designed to accommodate such requests under conditions carefully legislated by the Congress. These statutes will be re-scrutinized again by Congress, and we in ECAT look forward to sharing our views on these matters with you at a subsequent time.

As businessmen, it has always been our job to produce and market quality products at competitive prices. That is still our job, but it is a more complicated one by reason of the emerging global market place. Our competition now is with firms from around the world and not just domestic U.S. firms. At the same time, our marketplace is increasingly global rather than national. For management, this complicates our tasks but also dramatically increases our opportunities.

For government, the emerging world economy also creates a host of challenges and difficulties. The foreign trade deficit is a critical and troubling matter for the Congress and for the Executive Branch and certainly for businessmen.

What to do about it is a very major question that this Congress will deal with.

Perhaps the most important thing I have to say to you, in addition to the facts I have already mentioned, is that the issue is broader than just trade policy. It would be wrong to attribute the huge foreign deficit to just U.S. foreign trade policy. There are a number of key reasons for that deficit. Among them, in addition to the federal budget deficit, are reasons that we are all now familiar with. They include an overly strong dollar, faster economic growth in the United States than abroad, the enormous LDC foreign debt problem, an apparent decline in overall U.S. competitiveness and still some foreign trade restrictions.

In the strictest sense, U.S. trade policy deals with that latter one, the foreign trade restrictions, only, and it is encouraging that the United States is pursuing either changes in or elimination of these restrictions in a much more aggressive way in recent months. And these restrictions have been estimated by our Secretary of Commerce and by others to perhaps account for as much as 10 to 20 billion dollars of our foreign trade deficit.

We must be resolute in our efforts to seek more open foreign markets and we must vigorously enforce our unfair trade statutes and seek improvements in GATT provisions dealing with unfair trade practices.

A major part of overall strategy should be a successful conclusion of the already initiated Uruguay Round of multinational trade negotiations. These negotiations are important not only for sustaining the historic U.S.-led effort for trade liberalization measures but also for improving existing GATT rules and adding to the GATT new rules to cover not only trade in merchandise but, most importantly, trade in services and investment rules. It is also vital that rules to protect and foster exchanges of intellectual property be developed in the new trade negotiations. This is perhaps one of the remaining areas where the United States has most at stake and the largest comparative advantage because of our innovation.

I attach particular significance to that since the industry running in together with other high tech industries are experiencing great difficulty in having our intellectual property rights recognized and protected abroad. We are having our know-how and our products stolen.

This is a major problem for us both in maintaining and developing overseas markets. There is no prospect for success of the Uruguay Round without U.S. leadership.

Because I strongly believe it in the national interest that the new GATT negotiations succeed, I urge the members of the Finance Committee to grant the President adequate negotiating authority for the new round. While the President has the needed authority through the end of this year, that time will be fast upon us. And while much preparatory work needs to be done before any conclusive negotiations can be undertaken, I believe the fact is that our trading partners will hold back in their negotiating efforts until they see the Congress provide the President with adequate authority to conclude meaningful agreements.

ECAT recommended to the last Congress that the President be given a tariff-reducing authority for a period of no less than five years and that he also be given his traditional proclaiming authority for implementing U.S. tariff cuts.

ECAT last year also recommended extension of the fast-track procedures for a period of at least as long as is provided for the tariff-reducing authority.

There are a number of other issues related to any forthcoming trade bill that we hope we will be able to comment on at the appropriate time. In fashioning trade legislation, we hope the Congress will bear in mind the competitive effects of the legislation on U.S. industry.

Because of the imperative that U.S. economy remain in the forefront of international competition, I believe it is appropriate that the Congress, when legislating, take into account the impact of its prospective actions on the international competitiveness of American industry, labor and farmers. Were this the case in respect of last year's tax bill, I suspect that several of its provisions might not have been enacted.

I personally believe that elimination of the investment tax credit will prove harmful to the overall competitiveness of the U.S. economy, particularly the capital intensive sectors.

I further believe that changes in the taxation of the foreign source income will prove harmful to international competitiveness of a number of U.S. industries.

While different sectors of the business community have differing positions on some of the issues, such as the abolition of the investment tax credit, I am not aware of any significant differences in the business community concerning adverse competitive effects of foreign tax changes. A moratorium on them pending further examination could be a good idea.

We would also welcome revision of other anticompetitive provisions of a number of statutes, such as the Foreign Corrupt Practices Act and the Export Administration Act. We further urge Senate ratification of a number of bilateral investment treaties that are important to U.S. overseas investors.

Mr. Chairman, I will end here by repeating my call for development of an appropriate set of measures, both domestic and international, that can be implemented in ways that will restore balance to our domestic and external accounts in order to restore and foster a vibrant and competitive U.S. economy.

In so doing, we must operate in concert with our trading partners for the common good. There are no feasible alternatives to continuing international cooperation. We will either be a leading participant in the global economy or it will inexorably leave us behind.

If I might just add one or two postscripts, some of these things that occurred to me last night.

One thing, I think it is important for us to remember that it is unrealistic to expect that the United States will have a relative position in the world, the thing that we had 20, 30 or 35 years after World War II, where we dominated every field of activity. That was a unique situation caused by unusual circumstances and the rest of the world inevitably would get more competitive in the years ahead.

The so-called reducing American competitiveness could more accurately be described as the rest of the world achieving a more rational share of its competitiveness.

Another point is that one of the reasons for years that American business was reluctant to see trade legislation is that there are already positions in the law that allow us to cope with many of the main problems of the specific imbalances that we face. And rather than new laws in many cases, we need more aggressive implementation of the existing laws. I am encouraged to see that we are starting to get this by the current Administration.

Also, as I thought about today's session, we had a session of the Business Roundtable just a couple of days ago, and as I looked over the list of items that we talked about, they are all items that are on our agenda at the Roundtable because they affect the competitiveness of American industry. It is not just trade laws that affect the competitiveness of American industry. Some of these are equally important. I have already mentioned the budget deficit, which we feel is of overwhelming importance.

Our growing concern about tort reform in the United States, of the legal barrage that American industry is facing in all kinds of liability actions which distract us both in our funds and our manpower and our management time are not faced by foreign competition.

The exposure of major companies in our country to irrational raids and takeover attempts that are not in the competitive interest, not in the economic interest of our nation is another serious problem that we need to affect, need to adjust, to address in Congress. Taxation and the awareness of our legislators as we pass tax bills, their competitive impact is always a critical area.

Our approach to environmental issues. None of us fight the issue that we need to protect our environment, but to do this in a rational way with awareness of its impact on competitiveness is another critical issue that affects our competitiveness.

Antitrust laws and other regulations by the government are ones we worked on together. And all these things are the things that the business community concerns itself with because they affect our ability to compete and, therefore, the economic strength of the United States.

These are all issues that badly need addressing here.

I think we really have three special problems as you look at the overall trade deficit. The agricultural side of it, which is certainly not in my area but one that we have always been dominant in, and one where our strength has rapidly eroded is a very special problem which really relates to the fact that for the first time I guess in history, or recent history, we have a large world overcapacity in agricultural productive capacity. This is a critical problem which faces all nations, and if it isn't solved it will continue to be a source of great irritation on the trade and interbusiness relationship front.

Developing countries have special issues too that affect us. Their exchange rates are still out of line relative to ours which makes it difficult for us to export to them as does their staggering debt problem that we face, and the fact that they have a standard of living much less than the rest of us, which creates again products produced under unusual circumstances, a very special kind of a problem.

And then, finally, Japan, a special situation all in itself. I read Bob Strauss' testimony to you a few days ago where he made a special comment about the Japanese situation, the need to address it at a summit level. I think something of that nature is clearly required.

Japan argues that they are an open community now, and it is not fair to accuse them of trade restraints, but if you look back over history, it is clear they got to where they are by being the most effective practitioners of restraints to that nation I suspect in the history of the world until they were able to bring their market to a place where they don't need these restraints any more.

We have a situation with them which is intolerable. And in spite of I think improving efforts of American industry to compete in areas where the Japanese tend to be strong, I think it will need action at the very top in order to rectify that situation.

I thank you very much, Mr. Chairman, for the chance to speak.

[The prepared written statement of Mr. Pratt follows:]

STATEMENT OF EDMUND T. PRATT, JR., CHAIRMAN AND CHIEF EXECUTIVE OFFICER, PFIZER INC. AND CHAIRMAN, EMERGENCY COMMITTEE FOR AMERICAN TRADE, BEFORE THE SENATE COMMITTEE ON FINANCE HEARING ON MASTERING THE WORLD ECONOMY

Thursday, January 15, 1987

It is difficult to conceive a set of circumstances whereby the United States or any other country could master the world economy in the sense that the United States did in the period following World War II. With the astounding progress and dispersion of technological and industrial development worldwide in recent decades, the task for both business, labor and government leaders in the United States and elsewhere is to recognize how the world has changed, and is changing, and to adapt to these changes in ways that will foster both economic and social welfare.

In light of many decades of American economic hegemony, it is difficult and often painful to recognize that the United States is no longer the dominant world producer of many industrial and agricultural goods. Such recognition is rapidly being forced on us as we witness the effects of foreign competition both in our own and in foreign markets. It is critically important that we as businessmen and as government leaders respond to rapidly changing economic events in ways that will allow us to continue our world leadership in an increasingly integrated world economy.

Without the effective leadership of the United States during the last forty years, the world would be a very different sort of place than it is. I would guess that it very likely would be a much poorer world with considerably less international trade and investment. There also very likely would have been a lot more international economic conflict of the "beggar thy neighbor" sort that characterized the 1930s, which would have led to less international civility and more political unrest and conflict both within and among regions and nations. Many historians, for example, attribute the rise of the European dictatorships in the 1920s and 1930s in large part to the economic unrest that followed World War I. Such unrest was abetted by such acts of economic isolationism as the Smoot-Hawley Tariff Act of 1930 that effectively helped to throttle international trade and to diminish U.S. and world economic well-being.

I can tell you from my own experience as a member of the U.S. delegation to GATT ministerial meetings in 1982 at Geneva and 1986 at Punta del Este that without U.S. leadership the GATT would be a moribund organization, and that would be a shame for the United States and its trading partners. Without U.S. leadership over the years, tariffs among the industrialized countries could be expected to be in the 25 to 50 percent range rather than at the present range of 5 to 10 percent. The trade impact of such tariffs would have resulted in much lower employment and living standards around the world.

Imaginative U.S. leadership is now sorely needed to help guide the countries of the free world through the economic uncertainties facing all of us. What is needed is U.S. agreement on a domestic and international framework through which an open international trading system can be sustained.

From the perspective of a businessman such a framework above all calls for U.S. actions that will effectively reduce the federal budget deficit to proportions that will enable domestic savings to equal or exceed domestic investment so that we will no longer be a net international debtor. This would be the single most important action that the government could take as a corrective to the foreign trade deficit. Its effect on the exchange rate of the dollar would be salutary and it would go a long way toward improving the U.S. balance of trade and the current account. Indeed, in my judgment, the foreign trade deficit is directly related to the federal budget deficit. It is difficult to conceive of a solution to the trade deficit without a solution to the budget deficit.

There are other domestic actions that must be taken if we are to maintain an open international economic system. Some of these involve changes in the tax code and others pertain to changes in a variety of domestic statutes and regulations that impact our ability to compete in the world market place. I shall comment on some of these later.

Please note that I have initially touched on domestic U.S. measures that are necessary to developing a framework of measures that will enable the continuance of an open international trading system. Without such measures the outlook will continue somewhat bleak.

The framework also involves a number of actions that should be undertaken by other nations and cooperative actions that should be undertaken by all. Divergent macroeconomic policies need to be better coordinated among nations. The longer such efforts at coordination are delayed, the more difficult will be constructive solutions.

In the interests of maintaining a workable international economic system, Japan, for example, should not only effectively open its markets to more imports and foreign investment but also should take domestic steps to encourage investment and production for domestic consumption as a means of reducing Japan's excessive reliance on production for export markets. Excessive and persistent current account surpluses in Japan are just as intolerable in the long run as are the excessive current account United States deficits. Balance is necessary and is attainable through cooperative measures between Japan and its trading partners.

Fairly recent steps initiated between the United States and others in the areas of international monetary and financial cooperation and coordination are most welcome. They are a recognition that economic progress can best be achieved through international cooperation and not through unilateral actions that are at the expense of others.

There are a number of matters in addition to monetary and financial issues that should be discussed internationally. Principal among these are trade issues and I would like to talk a little about some of them in the time remaining to me this morning.

First, I would like to say that there truly is in place a world economy. While its component parts are the economies of the individual nation-states, the parts are increasingly being bound to each other through modern communications and transportation technologies. International trade, financial and investment flows are growing faster than is world production. Production itself is increasingly international in scope. A good example of this is found in the U.S. electronics industry where whole product lines in some instances are produced abroad for sale here at home by domestic electronics manufacturers and where components increasingly are being sourced in other countries for domestic assembly in order to take advantage of economic efficiencies that are necessary to remaining competitive in what is truly becoming an international industry. This observation about the U.S. electronics industry is equally true for the electronics industries of other countries as well as for a number of other separate industries.

Growing economic interdependence is a fact of life. It cannot and should not be wished away for it makes possible greater economic efficiencies worldwide with consequent increases in living standards around the world. At the same time it creates new uncertainties and it provides constraints on individual nations in managing their own economies. These constraints are often frustrating and sometimes painful. They, for example, impact upon wage rates and other costs of production and thus cause anger and sometimes lead to requests for protection from overseas competition. Fortunately, we have domestic trade statutes that are designed to accommodate such requests under conditions carefully legislated by the Congress. These statutes will be scrutinized by this Congress, and we in ECAT look forward to sharing our views on these matters with you at a subsequent time.

As businessmen, it has always been our job to produce and market quality products at competitive prices. That is still our job but it is a more complicated one by reason of the emerging global market place. Our competition now is with firms from around the world and not primarily just with domestic U.S. firms as in the past. At the same time, our marketplace is increasingly global rather than national. For management, this complicates our tasks but also dramatically increases our opportunities.

For government the emerging world economy also creates a host of challenges and difficulties. The foreign trade deficit is a critical and troubling matter for the Congress and the Executive branch. What to do about it is a very major question that the 100th Congress will deal with. Perhaps the most important thing that I have to say to you is that it would be wrong to attribute the huge foreign trade deficit to U.S. foreign trade policy. There are a number of key reasons for that deficit. Among them, in addition to the federal budget deficit, are reasons that we now all are familiar with. They include an overly strong dollar, faster economic growth in the United States than abroad, the enormous LDC foreign debt problem, an apparent decline in overall U.S. competitiveness, and foreign trade restrictions. In the strictest sense, U.S. trade policy deals with the latter reason only and it is encouraging that the United States is actively pursuing either changes in or elimination of these restrictions, which have been estimated by Secretary Baldrige and others to account for perhaps as much as \$10 - \$20 billion of our foreign trade deficit. We must be resolute in our efforts to seek more open foreign markets for our producers and we must vigorously enforce our unfair trade statutes and seek improvements in GATT provisions dealing with unfair trade practices.

To repeat what I have said earlier, I believe that the United States needs to develop a domestic and international framework of comprehensive measures for solving the foreign trade deficit that addresses the causes of that deficit. The attack should not be ad hoc but should be comprehensive and should be accomplished in concert with our allies, as I have already suggested.

A major part of overall strategy should be a successful conclusion of the already initiated Uruguay Round of multilateral trade negotiations. These negotiations are important not only for sustaining the historic U.S.-led effort for trade liberalization measures but also for improving existing GATT rules and adding to the GATT new rules to cover not only trade in merchandise but trade in services and investment. It is also vital that rules to protect and foster exchanges of intellectual property be developed in the new trade negotiations. I attach particular significance to the latter since the industry that I am in together with other high-tech industries are experiencing great difficulty in having our intellectual property rights recognized and protected abroad. This is a major problem for us both in maintaining and developing overseas markets.

There is no prospect for success of the Uruguay Round without U.S. leadership. All of the past GATT negotiating rounds owe their success to the United States. Western Europe has been and continues to be occupied with implementing the Rome Treaty that created the European Common Market. While it is a willing participant, Europe appears to have neither the desire nor the will to take on a constructive role of Uruguay Round leadership. Japan is unable to provide the leadership. The same is true for Canada and all others. The responsibility for success or failure, therefore, rests with the United States.

Because I strongly believe it in the national interest that the new GATT negotiations succeed, I urge the members of the Finance Committee to grant the President adequate negotiating authority for the new round. While the President has the needed authority through the end of this year, that time will fast be upon us. And while much preparatory work needs to be done before any conclusive negotiations can be undertaken, I believe the fact is that our trading partners will hold back in their negotiating efforts until they see the Congress provide the President with adequate authority to conclude meaningful agreements.

ECAT recommended to the last Congress that the President be given a tariff-reducing authority for a period of no less than five years and that he also be given his traditional proclaiming authority for implementing U.S. tariff cuts. Without such authority, the President's credibility would be diminished in tariff negotiations and our trading partners would be reluctant to negotiate if the U.S. tariff-reducing offers were conditioned on their being approved by the Congress.

ECAT last year also recommended extension of the fast-track procedures for a period at least as long as is provided for the tariff-reducing authority. Congress, however, might want to consider an indefinite extension of the fast-track since it is possible that ongoing negotiations within the GATT on a host of matters that are not subject to being completed in a finite period of time might continue beyond the new round itself. If Congress is unwilling to do this, then consideration might be given to providing assurances that needed extensions of fast-track procedures would be forthcoming provided that the Congress would agree to the negotiating objectives at hand.

There are a number of other issues related to any forthcoming trade bill that we hope to be able to comment on at the appropriate time. In fashioning trade legislation, we hope that the Congress will bear in mind the competitive effects of the legislation on U.S. industry.

The business community is aware that foreign trade is now central to the U.S. economy. The National Association of Manufacturers, for example, recently estimated that about 70 percent of U.S. manufactured goods face foreign competition. That is an enormous percentage. One result is the hastening of structural change in our economy. While such change over time will be beneficial from a national perspective, it does cause many adjustment problems for adversely impacted workers and firms. While the trade adjustment assistance program over the years has attempted to assist those seriously disadvantaged by competitive imports, we in ECAT believe that that program should be re-examined with a view to making it more a vehicle of retraining and education than it has been in the past.

In looking at problems associated with the foreign trade deficit and U.S. competitiveness, we hope that the Administration and the Congress will look at such fundamental issues as the educational needs of our citizenry in coping with requirements of the future. Maintenance of a strong manufacturing capability in the United States will in large part depend on the type and quality of education afforded to the work force. Maintenance of our technological base will require appropriately trained researchers and scientists. I know that business will do its share in providing financial support to educational institutions.

Because of the imperative that the U.S. economy remain in the forefront of international competition, I believe it appropriate that the Congress when legislating take into account the impact of its prospective actions on the international competitiveness of American industry, labor, and farmers. Were this the case in respect of last year's tax bill, it is possible that several of its provisions might not have been enacted. I personally believe that elimination of the investment tax credit will prove harmful to the overall competitiveness of the U.S. economy, particularly to the capital intensive sectors. I further believe that changes in the taxation of foreign source income will prove harmful to the international competitiveness of a number of U.S. industries. While different sectors of the business community had differing positions on such issues as abolition of the investment tax credit, I am unaware of any significant differences in the business community concerning the adverse competitive effects of the foreign tax changes. A moratorium on them pending further examination of their anti-competitive effects would obviously be welcomed.

We would also welcome revision of other anticompetitive provisions of a number of statutes, particularly of the Foreign Corrupt Practices Act and the Export Administration Act. We further urge Senate ratification of a number of bilateral investment treaties that are important to U.S. overseas investors.

Mr. Chairman, I believe that I am exceeding my allotted time and so I shall end here by repeating my call for development of an appropriate set of measures both domestic and international that can be implemented in ways that will restore balance to our domestic and external accounts in order to restore and foster a vibrant and competitive U.S. economy. In so doing, we must operate in concert with our trading partners for the common good. There are no feasible alternatives to continuing international cooperation. We will either be a leading participant in the global economy or it will inexorably leave us behind.

The Chairman. Mr. Pratt, thank you. And you obviously highlighted the enormity and the complexity of the problem.

I am going to observe the early bird rule here and give the listing as they appeared and you will be asked to question in that order. Senator Baucus, Senator Packwood, Senator Rockefeller, Senator Riegle, Senator Heinz, Senator Daschle, Senator Mitchell, Senator Danforth, Senator Armstrong and Senator Durenberger.

Both of you are heading very major, successful, multinational companies, and you have production overseas. There are a lot of pressures and incentives as you make that decision whether you are going to open a plant overseas or have it here.

I would like for you to address some of these things that enter into that kind of a decision to better have us understand what we can do here to make it more attractive to keep plants here.

To what extent are you influenced by antitrust, by wage scales, by environmental concerns, by exchange rates, by questions of productivity? If you would comment on that, either one of you and then the other if you will, please.

Mr. Young. The electronics industry is a little different than many basic industries in its cost structure, which I think would account for perhaps a little different view in how we might do things than you would get from someone else. Direct labor costs in our products are in the area of 2 or 3 percent of sales. So really changing things around to have a dramatic direct labor advantage is probably not going to be very high on our list of things to do.

As I indicated in my testimony, about half of Hewlett-Packard's business is gained from countries outside of the United States. We have sales companies in 40 countries, distributors in another 35, and we manufacture in about nine countries. I would say the most important motivator for locating something overseas is market access. It is ways of getting around those million subtleties that keep you from fully participating in those marketplaces.

We opened a new manufacturing plant in Spain last year. Did we arrive at this from some rational cost model that said this was the greatest thing for our company to do? No. Spain is very dictated by state industries and national purchasing policies, and it became very clear to us that we weren't going to be able to sell anything if we didn't locate a plant there to reply to their request for being a good citizen. Now these are the overwhelming, I'd say, factors in a lot of this kind of plant location activity.

So, again, it is the subtleties I talked about earlier, not the high tariffs or some of these regulations that you can get to, but things that are just never articulated, like the Japanese shared view about what to do, about who to buy from and who not to buy from. That is extremely important.

Now, of course, there are exchange rate issues, as I also mentioned. It is a very competitive world. And if the dollar goes up by 50 percent versus the mark—our largest European country is Germany; about 5 percent of our total business—pretty obviously our competitive position with respect to German manufacturers is enormously different. In fact, our competitive position with respect to other U.S. manufacturers in high technology, which are our principal competitors—it is not Siemens, it is more like IBM—but we have a policy of having these sales companies to have a local presence which, in fact, sponsors exports.

We have about two-thirds of the value-added in our export shipment that comes from the United States. That is why we are the thirteenth largest exporter. But if these currencies go off and the exchange rates go off, we are, in effect, unhitched. So our costs simply go off quickly and we have to respond immediately in order to avoid having just a complete upset of our whole business posture.

So these are some of ours.

The CHAIRMAN. Thank you. Mr. Pratt.

Mr. PRATT. Well our situation in industries in which we participate, which are primarily health care and consumer products, is largely similar to what John has just described. And I think if you look at the companies who went abroad in the years since World War II up until the very recent past, I believe you would find that almost all of them went for those reasons. They almost all went because that was the way you could develop the market. You could not stay home because all through those years after the war the rest of the world was in such difficult economic straits, they could not afford import products. So if you were going to build a market there, you had to go abroad and become a part of their society in order to do it.

Now an interesting thing happened, and I have quoted these figures here before for the last large number of years. If you look at the export statistics of the United States 40 to 50 percent of all manufactured exports in the United States go to the foreign-owned subsidiaries of American companies. What is the message? The message is one of the best ways to build the exports of the United States is not necessarily to build all your plants here, but it is to build some of them abroad because you have to be able to build a market in order to pull exports to you. And the figures are very clear on that. And it may be even a more dramatic figure.

I think something like 80 percent of all exports of manufactured goods are made by multinational companies. That means companies who are abroad there with the presence and who are building market shares. So that is the reason that we, and the IBM, and Hewlett-Packard to the world over the years build a strong foreign organization with manufacturing. We have had year after year in our company a very sizeable, favorable balance of payments for the United States, based on our exports and also from returned profits from those investments that we have abroad. That is why I think it is absolutely critical that we understand that we need to encourage that kind of activity and not discourage it, because it not only helps our balance of payments but it actually causes more employment here in the United States.

There are some other issues. It is true that a few of us have built plants, for example, in Puerto Rico because of a tax incentive. But that was a program that was supported by this Congress as a part of dealing with Puerto Rican problems of immigration and jobs for the people.

So, yes, there are a few cases where we have been so influenced, particularly in recent years, but the great majority of our investment abroad has been purely because that is the only way to develop the market.

I think you are going to find, as more and more foreign nations get concerned about whether the U.S. will be able to keep its open market that we have historically had, that they will start building plants here like the Japanese are now doing. It would be very intelligent to do so.

The CHAIRMAN. We have just gone from five minutes to seven for the time allocated. I see they ran a fast track on the chairman here. So I will ask my one more question.

Mr. PRATT. Fair enough, Mr. Chairman.

The CHAIRMAN. Tell me about that last point that you just made. It is intriguing to me when I hear a lot of people talk about the problems we give to our companies—and I haven't heard much of that from you two, which is interesting—as reasons for moving abroad. But what do you think are the primary motivating reasons for foreign companies making such a point of moving their manufacturing process here now?

Mr. PRATT. My view would be that they are trying to look ahead. And if I were in their position I would certainly be of the opinion that the United States cannot possibly sustain an unfavorable trade balance of the kind it has. And if I am going to protect my market there I had better get my roots down and be able to manufacture locally. I am sure that is why they are doing it.

The CHAIRMAN. You think that is primarily it?

Mr. PRATT. Yes, sir.

The CHAIRMAN. All right. So now it is seven minutes per member. Senator Baucus, if you would proceed.

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Young, I think you and your commission did a wonderful job in analyzing, trying to explain to the American people what some of our competitive problems were when you headed up the Commission on Industrial Competitiveness. And on the handout you gave us, which I take it came from your Commission's deliberations, you list about four or five major items that attribute to our competitive advantage or disadvantage. On that chart, it also explains which ones are most important compared with Some others. And on that chart you list areas where the United States, unfortunately, has the greatest disadvantaged competitive position, such as capital cost, exchange rates, and human resource cost.

I was wondering if, in your view as well as Mr. Pratt, that is as accurate today as it was when your commission report was issued a year or two ago.

Mr. YOUNG. Well, let me just explain this for a moment. Human resource cost as a major disadvantage is one we took pains to point out we wanted to keep. That is the whole point. Maintaining that standard of living is the definition, and so moving that down to some low wage country is not the goal, and I want to make sure that point is clear. That is why there is no arrow on there.

Senator BAUCUS. Right.

Mr. YOUNG. But when it comes to ranking of these things, the capital cost, I think it is potentially more of a problem for some segments of the economy, the capital intensive ones, with a reduction of the incentives for capital investment. But basically our commission recommended something very much like Treasury 2's proposition. And I think, by and large, it is going to be a better tax environment, and have a beneficial effect on capital costs over a period of time. But there may be some dislocations at the front end.

But there is no getting away from the fundamentals. We Americans don't like to save; we like to spend money. We have the lowest savings rate. And I think as long as that is the case, we are going to continue to have basically capital cost disadvantages, but I think the equity with which it is spread between industrial sectors has been improved with the new tax bill.

Exchange rates were said as a major disadvantage. It has gotten better. I don't think we have seen the full effects of that improvement yet. And, frankly, I think it has further to go.

Senator BAUCUS. But you still think that the relative disparity of capital cost is still one of our major competitive disadvantages?

Mr. YOUNG. I do.

Senator BAUCUS. Mr. Pratt, would you agree with that?

Mr. PRATT. Well I would agree with that. I think capital cost, in the final analysis, we do indeed sit down and evaluate projects and what they are going to return after you pay the cost of doing them, and the numbers do make a difference.

I would just add one other thing to that, and it touches on a broad subject.

I think one of the most critical things we need to do is to have a much closer relationship io our country between the various elements of our society. The Japanese have always done this. Business and government needs to work much more closely together than we ever have in the past. They do that.

How did the Japanese ever get started in the steel industry? I am told that our steel industry, the main reason that they did not modernize as fast as they should have, which is one of their problems, was that the state of the profits of their company and the availability of capital to them was so expensive they could not do it.

How could the Japanese have done it when they didn't have the business at all to start with? They got tremendous government support in doing that. And I think that is symptomatic of one of the big problems. In today's world, we don't have the luxury of all going our own ways. We have to be a more integrated society with some of the problems that means, and I think we are making progress in that regard.

Senator BAUCUS. How do we set lower comparative capital cost, and how do we encourage higher personal savings rates? How do we do that?

Mr. PRATT. That is why I think one of the problems of the tax bill went in the opposite direction. One of the ways you encourage lower capital cost is to give tax advantages and investment tax credits. That is what that was created for. And the industries who most need that lost it. So there are issues of that type that can be done in order—and those are what other countries do. John has spoken to the implication of saving and the broader economic issues on the cost of capital.

I think a lot of it though in the country who have done so well has been administrative efforts to force a lower capital cost I suspect is one of the key things.

On the issue of labor cost, I think we must realize in this country, and we don't like to do this, there are just some inspired, how hard we work, and the level of our innovation. There are some industries who are not going to be competitive with another nation that has labor cost a quarter of ours or a third of ours. We just can't be. And the more industries that those nations find themselves involved in, the more we face that. It is fine to say we ought to be smart enough and innovative enough to overcome that. And in the years past we usually could.

There is a much more widespread use of modern technology in productive processes than we used to have, and the ability to offset a great differential in labor cost I think is going to continue to be a growing problem in more industries. And how we focus on that is a major issue.

Senator BAUCUS. Do you have any suggestions?

Mr. PRATT. Well, the right answer would be to try to still be able to increase productivity enough to do it, to offset it, and we are trying to do that.

I happen to know they are trying to do it in the automobile industry with some success. Not yet as much as we would like to see. I think some industries, we are just not going to have to participate in, I am afraid. There will be no answer to it. And if it is a critical industry that you cannot afford to let disappear because of low cost foreign competition, and we cannot innovate enough to make our cost competitive, I am afraid I don't see any other answer but some kind of protection. I would hate to see that happen, but it may be the only answer in some industries.

Senator BAUCUS. How important is the present tax law in assessing our competitive position? Could you quantify that, please? I think, Mr. Pratt, you may think it is perhaps more important than Mr. Young. I don't know. If you could speak generally for U.S. business, and qvantify the degree to which our tax law is a competitive impediment. Fifty percent of it, 10 percent?

Mr. PRATT. Well, I would put it this way. In my own company it is not a negative impact of any seriousness. So my personal knowledge of the figures is not imminent.

I guess the best way I would measure it is at a time when American industry is struggling to be as competitive as it can be, I understand the tax bill shifted $120 billion of tax on people to industry. I guess that would be the best measure I could use of the impacts of it.

Mr. YOUNG. But neither of our companies were probably radically affected.

If you ever look at the effective tax rate by industrial sector, what you find is the tax rate will correlate exactly with the asset intensity of that sector. And so you can see when you get rid of the investment tax credit, you can predict exactly who is going to complain. All of those with above-average assets in their company are going to pay effectively higher rates. Those with less than average, like textiles, who are under the most intense international competition, ended up paying the highest tax rate.

So our commission was arguing for flattening it out. But having flattened it out, it still is relatively two to one higher probably than the Japanese right now, and maybe one and a half times as high as with Germany.

Senator BAUCUS. One more quick question.

You represent the CEOs of major multinational companies, and I understand that you look at the world through certain prisms. A lot of American businessmen in this country are small businessmen. And because about 75 percent of the goods and services produced in this country are in some form of international competition, in a very real sense, small business too is in international competition.

What advice do you have for the small business who cannot go offshore but is trying to sell perhaps honey to the Netherlands, or is trying to sell wool to some company overseas? In fact, most businesses are small business in America. What advice do you have for them?

Mr. YOUNG. Well, our commission looked at this question and had a number of recommendations we made, particularly about putting better information together on what opportunities are. We talked about enlisting our State Department network of commercial officers in a way different than has been the case, and make it the Ambassadors' responsibility to be, well not commercial agents for American business, but to see that as an important part of their goal to do that.

It is estimated by those who have looked at it that tens of thousands of American business could export but do not. And it has to do with a lot of ability of local banks to have enough information to know how to finance these activities, to see the business opportunities, to have a data base to see where world market opportunities are.

So we have a whole series of things we suggested to do there. And, frankly, I don't think hardly any of them have been addressed.

The CHAIRMAN. Thank you very much. That would obviously lead to some more questions. So I would like to call now on Senator Packwood. And we will have a second round of questioning.

Senator PACKWOOD. Mr. Young, both Senator Bentsen and I were surprised when you said that, I don't know whether you said wages or human resource costs were two to three percent of your sales.

Mr. YOUNG. Direct labor. No. Obviously our salary bill for presidents, janitors, salesmen, and so forth is quite a different number. But oftentimes you think about direct labor, people actually doing things. And in many industries that is a very big number.

The CHAIRMAN. Presidents don't. Is that the case. [Laughter.]

Mr. YOUNG. I realize I was being just handled off on that one. But you are right, at whatever level people work. Engineers, manufacturing supervisors, relatively they get paid more. But as I say, so often you think about direct labor cost. Those are the things people talk about rather quickly.

Senator PACKWOOD. What I wanted to know was on your chart. You said you want to keep human resource cost as a major disadvantage. And I understand what you mean. You don't want to cut our wages and have give backs so that we have parity on wages with Korea.

Mr. YOUNG. That's right.

Senator PACKWOOD. All right.

Now are you saying, where you have these arrows moving to the right, that that is the direction we are going under the present law; the laws need to be changed to get us there; or what?

Mr. YOUNG. That is the direction we would go if you follow the recommendations of our commission. And the length of the arrow was where we guessed we might get under optimum conditions.

Senator PACKWOOD. And if we got there under optimum conditions, then even though you had a major disadvantage on wage rates or human resource costs, even if you had a major disadvantage on that and a minor disadvantage on the exchange rate, you feel that you could internationally compete quite well.

Mr. YOUNG. Well, of course, the history of the United States in creating the wealth that we had, the real standard of living that we have had has been to use technology. And this is what we are saying in the upper right-hand corner. It is a great strength. We need to make it an even greater strength.

The facts are that our commercially relevant technology support in the United States is substantially less than our major trading partners when you take out the huge chunk that goes to DOD. You know, the federal government ends up sponsoring about 50 percent of the research and development done in the United States and two-thirds of that half is for DOD. It is commercial relevance by those who study that question is really quite low.

So we recommended a number of things. We were delighted to see the budget, as it came down, have a 15 percent increase for NSF and a target of doubling that over the next four years.

Senator PACKWOOD. Let me stop you just a moment. I just want to know if you are convinced that if the arrows move in the direction your chart says that we, the United States, can compete internationally even though there is quite a disparate wage differential.

Mr. YOUNG. Well I believe we can. That has been our history and I think that needs to be our future.

Senator PACKWOOD. All right. Now the next question. OECD every year issues comparative tax rates for the major industrial countries of the world, about 20 of them as I recall, they have listed total taxes, state level or whatever the local equivalent unit may be in foreign governments. As I recall, the eight or 10 major industrial countries, the United States in terms of total taxes is second from the bottom. Japan is slightly lower, although they do more things through business that we would call fringe benefits, social welfare things that we might do for them, as pay taxes and do it through government.

So when you talk about business cost or tax cost, you are not talking about the total level of taxation in this country, you are talking about the level of business taxation, aren't you? And, Mr. Pratt, at least you talked to some extent about taxes in your comments.

Mr. PRATT. Yes. I am not—I do not have the data right in front of me that you are referring to, Senator Packwood. The taxes that I am referring to, the type of tax, the way they are applied, we all know affect activity. I am really talking about those taxes—it goes back to the point I made earlier. I think in tax policy as well as all other policies, one of the factors that ought to get higher consideration than it has in the past, in view of the state of our current economic problems, is the impact of taxes on competitiveness.

Senator PACKWOOD. Well, I want to get to a question I want to ask you specifically, Mr. Pratt. I have looked at this report off and on for 10 years. It hasn't changed much. We are a relatively lower total tax country mainly because most of the industrialized democracies simply provide an infinitely greater variety of social services, and all governments when they do that are roughly equally inept and they are costly. And, therefore, our total taxes are lower.

But as a rule of thumb—there are exceptions—our taxes on capital and income are higher and our taxes on consumption are lower.

Mr. PRATT. Right.

Senator PACKWOOD. So the competitive business taxes are not necessarily lower. It is the total rate of tax.

Now in your testimony you recommended reinstituting the investment tax credit, which is about $18 billion of loss to the government, and narrow the deficit. I am curious how you recommend that we narrow the deficit, because it is an issue we are going to face all year, and at the same time lower business taxes or increase business incentives, call it whatever you want.

Mr. PRATT. I guess I would claim the right to some of the same kind of hyperbole that is often used by members of Congress, Senator. I agree that that is a contradictory. What I was pointing out is that from a competitive point of view, those tax changed I think were unfortunate. And I do believe that at the same time—the entire business community believes—the overwhelmingly most important problem we do face is the budget deficit.

The business community and I feel that we have to do more in reducing the level of our expenditures in government. We haven't done enough. We disagree with the Administration on some of their priorities there. It gets back again to the priority of this issue. This issue, I believe, now requires a higher priority than it has been given. So we do need, first of all, to reduce the deficit. And in so doing, if we have to end up paying more taxes, we would hope that would not be necessary. If it is necessary, we will have to do it.

We would hope that as we decide what those taxes are that the importance of the balance of payments and of jobs would be a major factor in the consideration.

Senator PACKWOOD. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Packwood.

Senator ROCKEFELLER. He has stepped out. All right. Senator Riegle.

Senator RIEGLE. Thank you, Mr. Chairman.

Mr. Young, let me say to you particularly, as I listen to you today and as I review the commission's report of two years ago, I am struck by the fact that this was produced in January of 1985. It basically said just about everything you are saying today. It laid out the problem, laid out the blueprint, and yet so little has been done in terms of actually implementing the specific recommendations of that report. In fact, some of the things that have been done are contrary to what you recommended. We have just been talking about some of the tax law changes, particularly.

And I am struck by that because the clock is running. I have updated two of the charts that the Presidential Commission submitted. One is the trade deficit on a chart that is accurate to scale to give some idea of the expediential change. And certainly in the more recent years we broke into that deficit—the flat line across the top being a balance of trade—we broke into that deficit in the late 1970s, but actually the explosion in the size of the deficit, the trading deficit, has really come here in the 1980s. And, of course, our worst deficit was the one for the year just finished, probably $173–175 billion.

But the thing I would like to ask you to focus on, is the second chart, which isn't our income statement on trade but the balance sheet and how we are doing in terms of our international financial standing.

Now we are reading in the paper today that we have got a free fall going in the dollar. Some people think that is a good idea. Some people really worry about what that may cause to happen if it continues.

We have had a very substantial downward valuation in the dollar, particularly versus the Yen, about 40 percent, and yet our trade deficit with Japan went up substantially during the same time. So it is not exactly clear whether exchange rates by themselves are able to work the magic to bring these trade deficits around.

But the thing that I would like to have your response to again, if you look at a scaled chart of the rate of change as we have gone from a creditor nation to the number one debtor nation, and with the Federal Reserve Board of New York now estimating that by 1990 we are going to owe the rest of the world a trillion dollars. As I see this massive debt accumulating, we have got this huge federal budget deficit that you and Mr. Pratt both speak about. We are all alarmed about it. We now have this huge international debt that is building at the rate of about $1 billion every two and a half days.

I am wondering how much longer we have to be able to stay on these trend lines, as damaging as they are, before we start to exhaust our capacity to even carry out the remedies that we have been talking about for at least two years and about which very little has been done.

If I take your chart, for example, that you were just discussing with Senator Packwood in the areas where we need to move forward and make change, some of these require capital. Certainly product technology, process technology, capital cost, very directly, and others on here, directly relate to the level of resources we have, our national wealth. Do we have the money to invest? Can we plug it in to do some of these things? Not that money alone does it, but that helps drive the process.

I am wondering what your respective professional opinions are as you think about this international debt of $1 trillion or more by 1990, which is not very far away. Are we running into a danger here that we are going to put ourselves in such a financial hole, while we talk about these things but fail to act, that by the time we reach a consensus to act we may be so handicapped financially that we may not be in a position to respond as aggressively as we are going to need to in order to get out of this hole?

And I would like your answer on this question of how much longer we have with respect to this kind of financial and capital in government that I think these charts show us is taking place here.

Mr. PRATT. Senator, you made the speech I really wanted to make when I came here. It scares me to death, to be perfectly frank.

I keep having lunches and dinners with my economist friends in order to get somebody to tell me the answer to that question. I think that's funny. He used water; I used fire. He said, we were debating these issues on the deck of the Titanic. My analogy has been, we are talking about long-term things that need to be done while the house is on fire. I just cannot conceive of us continuing to go on without the roof falling in on us. I am not enough of an economist. And the thing that boggles my mind is, if you will pardon me, how our government sort of goes on doing the same old things, talking about the problem. But if this were a company, I mean, we would have been around the room doing the most dramatic possible things we could do because we think we didn't have many days left. Now that is probably not true about this country, but the numbers say to me it ought to be. And I think that is exactly the problem we face and I can say again it scares me to death.

I think we need to be doing much more dramatic things. They are going to be painful things, but I think if we had done them two or three years ago they would have been less painful. If we do them two or three years from now, the free fall of the dollar is bad. I don't think there is any question. Most businessmen have absolutely no question that the dramatic change in the balance of trade was caused most of all by the change in the dollar the other way. It is not that easy to turn it back around again and we didn't think it would be. In the long run it ought to make a difference, but in the long run it may be too late.

So I really believe you. You have hit the nail right on the head. And that is why we are here, frankly. That is what kept me awake last night, trying to think of other things that might be helpful. I think we have an absolutely critical problem facing us.

Mr. YOUNG. Well we have a lot of issues that we have talked about here. And I think just to underscore a couple of things that I have tried to make in my testimony that certainly stick out for me, and that is that we simply do not have the mechanisms in place to keep these imbalances from developing. And I am sure that the Japanese businessmen may have been rubbing their hands on the upside in here, but they are now writing about hollow factories in Japan. They are passing work out all over Southeast Asia. And it is no fun to be on the other side of this. So we really need to have stability, and we need to control the rates at which things change, because it is that rate of adjustment that is so hard to make.

So my own view is that we really need to continue to get the exchange rates to go down. If you go back to 1980, one of those balanced points and when things were about the same, and you make the right inflation adjustment—I am using Morgan Guaranty Trust

Company economics here—you know, you need to see the Japanese yen at about 1.36 and the market about 1.68.

So I think these are the kind of things we need to still move toward to get that deficit turned around, because don't forget, on that $1 trillion debt we are going to have to have a manufacturing trade surplus of about 60 to 70 billion dollars a year to service that debt.

Senator RIEGLE. Yes. My time is up. That is precisely the point. But I hope you will find an occasion to elaborate on that this morning because I don't think people are thinking in terms of what you have to change in order to be able to even service these debts in the future, little alone pay them off.

The Chairman. Thank you very much, gentlemen.

Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Mr. Young and Mr. Pratt, I apologize for missing half of your testimony, Mr. Pratt. There is a way of thinking that there has been an inevitability about trouble in the manufacturing sector in this country, and, obviously, it had to do with steel and certain kinds of heavy industry. But we premise that on the fact that there were other types of industries, high tech, that could bail us out and that we would stay smart and stay ahead because we would have high tech and we would have services to sustain us.

There are those who would say we cannot compete in some forms of manufacturing. They say that services are productive, that banking and being a lawyer, being an architect, all of these are useful things for the future.

I guess my first question to you, Mr. Young, would be: is it possible to have a successful service economy without a successful basic manufacturing economy?

Mr. YOUNG. Well our commission debated that subject, and I have thought about it a lot subsequently, and I think I am firmly convinced that it is not the case.

Manufacturing matters. And, incidently, that is the title of a new book in publication by some economists at Cal Berkeley. That shows that instead of the typical 18 percent one quickly thinks about in terms of the employment fraction that goes into manufacturing, if one looks at those closely associated necessary service things—and, after all, retailing is simply distribution of that kind—you are really talking about something more like 55 percent of the employment.

Senator PACKWOOD. What did you just say at the last point?

Mr. YOUNG. About 55 percent of the employment is very tightly associated with manufacturing.

So if you really look at services, most of the important ones are done on or for some manufactured product. Most of them today are not tradeable, not likely to be big tradeable affairs. And I think you come inescapably to the conclusion that manufacturing does matter. And having a vital manufacturing sector, never mind national security issues like we are talking about for semiconductors, but just for the national health—the underpinning of the whole thing I think it has to be an important ingredient and a growing one.

Senator ROCKEFELLER. Just following up on that for a moment, is there any reason to think that those newly industrialized countries, can't come in, as they have in manufacturing, and excel in providing services just as they have done in manufacturing? Is there any reason to assume that services is a special prerogative for us and not equally available to others?

Mr. YOUNG. Well it is certainly not. You know the largest banks in the world are Japanese now. Insurance companies, major insurance companies, certainly not. We are going to face the same kind of competition there. We have a strong service element in our economy and it is good. But it can't be the only thing, of course. And it will indeed be competed with.

Senator ROCKEFELLER. Is it not also a fact that in terms of competition in the service industries that we are in fact finding it very hard to gain access? Others will gain access here. We find it hard to gain access there.

Mr. PRATT. That is certainly the case. And I think a lot of what we are saying about the next GATT round is these are all again exactly the same things unfolding that happened before, a closed market, protected issues, while they gain the strength of underspanding and they just simply move them out into other marketplaces.

It is one thing in the years past with a great dominance to sponsor this kind of thing. It is because countries, after the war, needed to have a special breathing space to gather their industries together and so forth. It is very hard to make that same case today. And yet the same kind of comparative development is just moving from sector to sector to sector. You can see it happening.

It also emphasizes the importance of things like protecting our international property rights. It is an interesting observation that the very industries that Japan has dominated most were almost all based on innovations from this country. And that is indeed still our ace in the hole. We are still the most innovative nation in the world. We still spend a great deal more on research than anybody else, although that need is narrowing. And to protect that is a critical national issue of importance. That is why we worked so hard to get it on the GATT round and why we are doing it on a country by country basis in negotiations with countries around the world.

To give you an example, in our industry it cost us about $100 million to develop a new pharmaceutical, and in the number of countries in the world it is on the market by one of their local producers before we can get it on.

Mr. YOUNG. Just to bring this down to kind of a personal level, if you are a personal computer fan at all and you use spread sheets, you will know that Lotus 1, 2, 3 is one of the most commonly used ways of displaying a spread sheet. It typically sells for several hundred dollars. You can buy it in Hong Kong in any bizarre, including the floppy, for a dollar.

Senator ROCKEFELLER. Well what do we do with the law of similars in Brazil, for example? In other words, if they are making computers and are getting technology from us, adding some of their own, and making good computers, and they keep ours out because of the law of similars, what do we do in trade policy, in public policy, when we are watching an eroding manufacturing base counting on high tech innovation and leadership and then in one prime example mentioned by you, and another in Brazil, simply shut out. I mean, what do we do about that?

Mr. PRATT. We have to negotiate much more toughly than we have in the past.

Senator ROCKEFELLER. And what does that do?

Mr. PRATT. Well it tends to restrict their ability to close their markets to us, to steal our technology, and to take our markets with part of that technology. It does all those things. It is the famous level playing field. We need a level playing field. And we cannot do that alone. We need government support and we are beginning to get it more than we have had before. We have made some meaningful advances. We have a long way to go.

The CHAIRMAN. Thank you very much, gentlemen.

Senator Heinz, proceed, please.

Senator HEINZ. Mr. Chairman, thank you.

I might ask unanimous consent that a brief opening statement I have be placed at the appropriate point in the record.

The CHAIRMAN. Without objection.

Senator HEINZ. Mr. Young and Mr. Pratt, welcome. And I commend both of you on your long time work in this area.

I commend you both on your testimony. What we seem to be achieving even after just two days of Finance Committee hearings is a fairly broad agreement on the nature of the problem and what comprises competitiveness.

Mr. Young, in your testimony, which was very, very thoughtful—and I suppose you can say you had the advantage of spending a good portion of your life on the new reality which your commission produced—you focused on your recommendations on what we can and should do to modify our behavior: reducing the federal budget deficit; more incentives for the appropriate kind of capital formation; more attention to research and development. And I think all of those are extremely important.

You paid relatively less attention to what we ought to do to modify other people's behavior, although you suggested that you had to build a plant in Spain because that was the only way you are going to do business there. Now that is not an isolated example. Practically every country in the world has enormous performance requirements, and many of them don't stop, as Senator Rockefeller just indicated, at that. For example, a Law of Similars, as they have in Brazil, is sheer protection. It simply says, if we make it, you can't come in through our door.

I am sensitive to Mr. Pratt's comment that, you know, the house seems to be on fire and we don't want to talk about planning for the development of a larger neighborhood while the house is on fire. Nonetheless, it seems to me that if we are ever going to get a regime that observes the notion of free markets, where supply and demand rather than the amount of government interference is what is reflected, we must pay a lot of attention to the behavior of others.

You mentioned, John, in your statement, Taiwan as a country that had been quite successful in manipulating its exchange rates. And my question to both of you is, it is no secret that there are countries that are pursuing merchantilist, anti-free market, anticompetitive policies. And I am not talking about non-market economies. I am talking about Japan and Korea and Taiwan. And the question I have for you is, why do you appear, both in your chart in the back and in your testimony, to give that relatively low priority? It seems to me that over the long term we will never make any real progress as long as other people play the game according to their own very advantageous set of rules.

Mr. YOUNG. Well I am not sure that I perhaps was as balanced in all the things that I discussed as maybe I could have. I guess I am very sensitive to the point that, the point about the chess game. You can get really excited about market openings and all of these things that happened to us, access to Brazil's computer market. If we sold them every computer that Brazil ever thought they were going to need next year, how much would it dent that $170 billion? Well I think Ed had the number; that those people who thoughtfully look at these market—serious market distortion things maybe get a number of 20 or 30 billion dollars. We are talking about $170 billion.

Senator HEINZ. Gentlemen, let me interrupt you at that point. I understand that and I think that is absolutely accurate. We eliminate all those barriers in Japan and every place else. Would that enable us to export a great deal more to cure our trade imbalance? The answer is absolutely not, not for many years. Maybe 5, 10, 15, 20. I don't know.

But to what extent have you, or for that matter, Ed, focused on the longlasting competitive ability that a merchantilist policy confers permanently on a country such as Japan when it keeps not just us but everybody out? It keeps its domestic prices at whatever level it wants, can subsidize its research and development in a way we don't here, subsidizes its product engineering, causes the leapfrogging of technology that renders a product that you may make obsolete far sooner than you ever thought, all because of a particular construct, whether it is cultural, societal or governmental, that is vastly different from what we thought the rules of the game ought to be? Isn't that a serious problem?

Mr. YOUNG. It is a serious problem, and I have thought about it and I don't quite know how to get at the answer. I don't know how to parse that kind of comparative advantage generation from exchange rate problems. And I guess what I was suggesting in my testimony is that some of these are so subtle, so embedded, so a part of the fabric of a nation's thing that maybe the only way to see if the game is fair is to back up and look at the flows. And if they are not, rather than try to unscramble why it happened, you simply have to get together with the Japanese and say, this is an unstable situation. Those flows have got to get balanced or some semblance of balance, and we don't care which handles you pull to do it. But they have to realize that systematically doing this just creates a bigger problem some other place. I guess that is the trouble I have in kind of focusing on it.

Senator HEINZ. One brief question which I will address to Ed in the time remaining, which is this. We all recognize the primacy of financial flows. You were quite correct to point those out. There is a conception that the dollar is down, has weakened 25 percent. Versus our seven largest trading partners accounting for 61 percent of our trade, the dollar has actually strengthened 11 percent. What do we do about that?

Mr. PRATT. Oh, I think the answer, unfortunately, to both of those questions, the one you talked to John about, and I am sorry to say you don't find it in my testimony either, a lot of discussion about what we ought to do about that problem. And I think that the reason for that is that most of the things that come to mind to cope with that kind of problem that you have described come under the broad heading we have all called protectionist. And the business community has long been concerned about taking steps of that kind, leading to a reverse in the direction of the general move toward a better world economically integrated order.

We could afford to have that luxury up to now, and we have been the nation that has stood for that. And as I have mentioned in my testimony, for that we have generally lead the world to a freer, better interchange.

Some of these problems that you raised, I really don't see any answer to them, other than greater governmental intervention. And we don't like the idea of that either. The business community inherently doesn't. And I hope I am wrong, but I don't. And you are right when you describe how Japan got to where they are, and if we get rid of all the now existing clear barriers, what would it do?

The reason for that is the barriers have done their job over the years past, and just eliminating them doesn't change the situation. You are absolutely right.

I did mention that I think Strauss' comment of the Japanese one particularly, and John just said, a direct intervention at the governmental level is probably going to be necessary. So whether what I said was much more strongly motivated negotiations between nations, all of that really says we have, I am afraid, got to adopt to some extent some of the devices they have used to put themselves in that position. We don't like to become like the Communists to fight the Communists. We don't like to become like those who have used economic policies we don't agree with in order to compete with them. We cannot ignore, in some cases, the effectiveness of what they are doing. And I think we have to perhaps adjust our approach to a more direct confrontational basis, but not on the basis—I think the answer lies in negotiation, direct negotiation. Not to pass a law that has froze up a tariff and retaliation.

I would give a couple of examples. I think the automobile restraint agreement, whether you believed in it or not, was a direct attempt to do that sort of thing. And is it protectionist when two nations agree on a policy which is in both of their interest? I suspect that is a debatable issue.

We ought to do all the things we say we ought to do. We ought to do the things that help our competitiveness. We ought to implement the trade laws that have been agreed to. All those things will help. The problem is a lot of little things that need to be—whether that is going to address the big imbalances sooner enough, I am not so sure. And then I can come to only the final conclusion as the one I suggested.

The CHAIRMAN. Thank you very much.

Now let me give the order of questioning on the arrival list. And the next ones will be Senators Daschle, Mitchell, Danforth, Armstrong, Durenberger, Matsunaga and Pryor. And I would now like to call on Senator Daschle.

Senator DASCHLE. Thank you, Mr. Chairman.

You both have indicated that you think part of the solution to this complex dilemma that we are facing rests with greater involvement on a multinational level rather than a bilateral level. Aside from calling for more leadership on the part of the United States, how do you think that will be promulgated? What is it that will bring about greater multilateral involvement in the process? And aren't we going just in the opposite direction, as you point out in your excellent testimony, where we have gone from 40 percent to 15 percent of GATT involvement? How do we turn that around and is that in our best interest?

Mr. PRATT. I will make a beginning comment. In my own judgment, the solution is going to have to be a combination of multilateral and bilateral activities. As I said, I was down to the GATT round, and those members of the various nations of GATT tend to fur up when you talk about a bilateral doing anything because you are destroying the multilateral. And it is true that in principle and theory a multilateral common agreement of rules of the game make for a much freer and more efficient world economy and we should word toward that.

GATT is not the only organization that is the main one. There are varying views about how successful it has been. I thought the session down there was a meaningful step, and I think we need to support it strongly as we can. I think it gives an overview of creating. Just the fact that we got intellectual property agreed by all those nations to be an issue of discussion, and for creating world rules gives it a credibility that it didn't have before.

In my own judgment, however, in my working lifetime, maybe even in my lifetime, the real advances are probably going to come mainly from bilateral negotiations within the framework of a developing GATT umbrella.

As you know, we have reached a meaningful improvement with Korea. One thing I might say in passing, if there is an advantage to this serious problem we are talking about, this unbelievable intolerable trade deficit we have, it is that it gives us much more leverage in negotiations with our partners than we have had in a long time. You have really got something of concern to them. And we are able to deal much more strongly with foreign nations now when they have a huge share of our market they are trying to protect.

So in Taiwan, in Korea, in Mexico, in Canada, and lots of countries we have made meaningful advances on a bilateral basis; I think we need to do both of these.

The CHAIRMAN. If I might interrupt for a moment, Senator Daschle, and we will not take this from your time, to do a little business of the committee.

One of the mechanical problems is having 11 members of the committee here at one time to conduct its business, and to show you the intensity of the feeling about the issue, we have had almost every member of this committee here at some time or other. But we have the competition of other committees that they are on.

So I would like for us now to consider what we discussed at the business meeting before these hearings started, the budget of the committee. You had it presented to you now. And if we can get a motion on that.

Senator **Packwood**. Mr. Chairman, I would move the adoption of the budget as presented.

The **Chairman**. The motion has been made. Is there a second?

Senator **Riegle**. Seconded.

The **Chairman**. All in favor of the motion as stated, make it known by saying aye.

[Chorus of "ayes."]

The **Chairman**. Opposed?

[No response.]

The **Chairman**. Thank you very much, gentlemen. I will see that Senator Daschle gets at least an extra minute. Go ahead. [Laughter.]

Senator **Daschle**. Thank you for your generiosity, Mr. Chairman.

We seem to be giving the notion of greater multilateral involvement lip service because there appears to be more tangible results in bilateral negotiations. We sent a different message every time we send a negotiator to Japan than we do to Uruguay because there is something to come home with there. And there seems to be less and less real interest or real participation because of the intangible results which come about by this multilateral involvement. But could you address that?

Mr. **Pratt**. Well maybe I look at this too simply, but what I see in trade policy in the GATT these kind of rules of the road is being extraordinarily important. It needs to be fair. It needs to be as comprehensive as possible, and to the extent that it can treat the rules of the game, it should, including intellgectual property, all sorts of annoying and unfair things. So I strongly support that. I think it is extremely important that we should take a leadership role.

Having done that, we still have got a big problem. And that big problems stems from I think two issues that I mentioned. One, some of these market distorting practices are so subtle I don't think you are going to scoop them up in that net in the way that is going to deal with them. And, secondly, this world financial system, supernational system, that makes this economic judgment thousands of times a day, 24 hours a day, is an inescapable lock that is going to cause things to happen, things go off if we do not have the freedom in this interdependent world of the unilateral actions in our economy nor do others. It is what forces you back for having to find another kind of mechanism, bilateral, small, or multilateral, that corrects the larger system. That needs to have a kind of a real time tuning so that these big imbalances don't cumulate. That is when you have these really serious problems that causes terrific human cost and dislocation cost around the world on both sides of the equation.

Senator **Daschle**. On page 6, Mr. Pratt, you say, and you underline this, so you feel very strongly about it, "That it would be wrong to attribute the huge foreign trade deficit to U.S. foreign trade policy." And then, Mr. Young, you say that "trade policy really could only even potentially bring us up to parity with regard to our international commercial position."

The impression I have with both of your statements is that you don't think, even if we wrote the finest law possible, that we could create much more advantage than simple parity with other countries. In fact, I get the impression from your statement, Mr. Pratt, that you don't know whether trade policy should even be addressed in law, given the fact that you cannot attribute much of the trade deficit to trade policy today. Is that a misunderstanding of your statement?

Mr. **Pratt**. It is probably an overemphasis. The reason for emphasizing it is that we are concerned that many people think that if we just write the right kind of trade bill we will solve the problem. And the answer to that is no. But the inference is certainly not that we shouldn't have the best trade legislation that we can have. And from two points of view that tends to deal at a domestic way to help us be as competitive as possible, and is a basis for a program to try to negotiate with our trading and business, international business partners on a level playing field.

There is no one issue here. And I think we have tried to highlight that. But they are all important. And I think most of us feel the budget deficit is the single most important issue, but there are many others which are very important.

And as you well know from Congress, I am sure you have the frustration of writing trade policy and then not having it implemented the way you would like. And so one of the things we emphasize too is that the trade policy needs to be implemented. Even the trade law we have now is good in many respects. Congress has made some important recent improvements in it. The issues added to the 1984 Act which gave us a basis for negotiating better protection of intellectual property investment rules was an important move because these are critical issues. So there is already good trade policy out there and that is important.

The **Chairman**. Thank yow very much, gentlemen.

Senator Danforth.

Senator **Danforth**. Gentlemen, first, let me apologize for having to leave the room. The Commerce Committee had its organization meeting at 10:00 o'clock which I had to attend and it took more time like some of these organizational meetings.

I only have one question, and that is, what do you think we should do and what do you think we should not do? Obviously, whenever there is a serious problem, and a $170 billion or so trade deficit is a very serious problem, we in Congress want to at least purport to address the problem. Senator Bentsen, rightfully, has identified trade as the big issue before the Finance Committee this year. Senator Hollings is anxious to get into this area on the Commerce Committee. All kinds of ideas have been generated, are going to be generated to try to deal with the trade deficit.

You have spent a lot of time thinking about it. I am sure you have heard a lot of suggestions that are good and a lot of suggestions that are bad. What I would like from you is whatever thoughts you would care to give us as to the dos and don'ts, what are the best things that we could be doing in Congress? Granted, Congress isn't going to turn this around on a dime, but we are legislators. Our job is to try to legislate.

What are some of the best legislative ideas that you have heard and what are some of the worst legislative ideas that you have heard?

Mr. PRATT. That sounds like a Young question to me. [Laughter.]

Mr. YOUNG. It is called a lateral Arabaskin business. I really don't know how to respond to that. I think the more philosophical tone of our discussions today, and I am just delighted that we had the opportunity to participate in this kind of a discussion because I am afraid maybe the do's and don'ts of the kind you are asking for, you are going to have wall-to-wall petitioners lined up from here until May.

And I think if Ed and I can make any contribution, it is to see those petitioners in the light of what really is a very much larger problem, a very complex interact problem that even perhaps goes beyond the kind of trade policy issues that you have to address legislatively. And I hope that maybe we have stimulated further interest to see how to investigate and how to deal with this broader set of questions.

I guess my do's and don'ts don't boil down to support adjustment mechanisms or voucher systems for retraining. I don't think we have time to develop those issues here this morning. We would be delighted to at least put forward our views and we will probably do so.

I guess if there is anything I would like to just leave you with is just to use that competitiveness set of glasses as a way to view every one of those petitioners. Because many of the things I think you are going to hear, many of the ornaments that got pinned on that House bill last year I think are very anticompetitive. And I guess if there is any optic we can leave you with, I guess that is what I would urge.

Mr. PRATT. I would certainly endorse all of those things, Senator Danforth. And I guess as to what you shouldn't do, I think even though we view this situation with not concern but alarm, the business community I think generally still feels that in the desire to lash out at people who have unfair advantages over us, we could indeed make it even worse.

So I think restraint in doing—we have to do some dramatic things. I think we have to negotiate tougher. I have said that. We have to confront nations who are major problems in mutual, difficult overall negotiations.

Unilateral laws throwing up retaliatory efforts are difficult I think and are probably not the right way to go.

I think, as I am sure Congress knows, in writing trade laws I think you need to be careful not to tie the implementing authority's hands too greatly. I know Congress doesn't feel it can run the trade program. And they are frustrated by lack of enough to act. So are we.

But in reacting to that to do things that will encourage the kind of action you feel is appropriate, that will perhaps give more authority where necessary to the Executive branch, I think in the final analysis the law should be careful to use restraint in not trying to become directive rather than to create an atmosphere within which the proper action can be taken.

I would say again—you weren't here. I think some of the obvious things that ought to be done in the negotiation process is important. You ought to give the President the authority he needs.

The things that are before you to make the existing trade laws better and more effective in dealing with abuses—those are good things to do. I think issues like the way we have handled the longstanding problem that is fairly sizable—you know, nine or ten billion here and nine or ten billion there, and pretty soon you have got real money—but the recent story that the National Science Administration came up with, they estimated that nine to ten billion dollars a year of exports are lost because of inappropriate administration of export control laws.

There are things like that. All of these add up to important things, and we will have detailed presentations, a roundtable with ECAT and others. We have lists of those things that we believe are sound and which speak to the problem.

Senator DANFORTH. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much. Senator Matsunaga.

Senator MATSUNAGA. Thank you, Mr. Chairman. Mr. Pratt, I apologize for not having been here to listen to your opening statement but I have gone through your written statement, I note, Mr. Pratt, that on page 1 of your prepared statement, you raised a question of your sanity about appearing before this committee. Well, you might be relieved to know that, according to one reputable psychiatrist, we are all insane; the only difference is that some are more insane that others, and when they fall in that category, you usually find them in institutions, such as the U.S. Senate. [Laughter.]

In your report to the President on U.S. competitiveness, you cited the need for American firms to have a flexible attitude toward changing international markets and recommended that the Government adopt policies to help American firms respond to changing markets.

What kind of policy specifically did you have in mind?

Mr. YOUNG. Policies, I think primarily, aimed at worker adjustment. Now, I gained a fresh perspective and a new appreciation for the tremendous value our country has in labor mobility. If you look over the last 15 years or so at the fact that we have created 20 million new jobs and you look at Europe who, in that same period, experienced a net loss of jobs, then you try to come back and say: What is the difference?

The difference largely is kind of a social democratic tradition that in many ways—laws and customs and so forth—leaves things in place. On the other hand, the Americans still have that spirit of doing new things and so forth.

Our Commission had union leaders, academics, and so forth. We had some spirited debates, and I learned a lot of things about that from other companies who have more serious problems than our own. We have never had a layoff in the 48-year history of our company.

So, I began to appreciate some other activities; and the impact really should not fall on these individuals and that it is good public policy to sponsor the kind of flexibility that gives the labor mobility to redeploy our assets in the most appropriate sectors as we go along.

And I think this is kind of the thrust of the recommendation we are making.

Senator MATSUNAGA. Now, your report specifically recommended that the Government intensify trade promotion efforts through an interagency effort to include the collection and distribution of market information to potential exporters.

How much of that is going on today, and to what benefit does it serve the business community?

Mr. YOUNG. I am not aware of any response to that recommendation over the last two years. So, I don't think there has been any particular change in the ability to help those tens of thousands of medium and smaller businesses that could export but don't.

Senator MATSUNAGA. I was listening to the news this morning, which carried a report of a TV sales promotion of American goods in Japan just recently. Within an hour's time, five million dollars worth of American goods were sold to Japanese consumers. Do you know if this promotion was conducted by the Government or by business?

Mr. YOUNG. I doubt if the Government was conducting that sale, but I really don't know. We may be down to that before long.

Senator MATSUNAGA. Perhaps the business sector ought not to be waiting for the Government to act, but should act on its own. I think the private sector can move much more rapidly than the Government, especially since we have a difference in policy wherein the Executive pursues a policy of getting Government off the back of the private sector.

Of course, with that division in thought and philosophy, we have extreme difficulty because both the Executive and the Legislative branches must act in order to formulate a national policy.

Mr. YOUNG. Your point is well taken. I think, in our own company's case, we have had a company in Japan for more than 22 years. It has $.5 billion in sales and is one of the most successful companies there. It is quite different for some very small businessman in Kansas to emulate that approach to breaking into the market.

And I think the thrust of our recommendations was much more how to utilize more effectively the kind of market information that the Government already collects to make sure it would be used as much as it could to stimulate additional people to come into the export market, to be aware of market opportunities and pursue them on their own.

It wasn't for the Government to act as their sales agent in any sense.

Senator MATSUNAGA. What is your estimate of the number of salesmen or promotional agents, in Japan, who are trying to sell American goods there? How many Americans are involved in this activity from the private sector?

Mr. YOUNG. How many Americans? I really couldn't comment on that. I know in our own company there are zero. There are none in Italy; there are none in Germany; there are none in Sweden. There are none anywhere. I mean, their whole idea is to have local management and people who are a part of the environment.

Senator MATSUNAGA. Now, isn't that an area in which the private sector can do something because, in any single day, I am told that there are only about 200 Americans trying to promote American goods in Japan, while here in the United States I am informed there are nearly 3,000 Japanese trying to promote Japanese goods in the United States? The chairman of the board of NEC of Japan, Mr. Koji Kobayashi once said to me, "You know, you Americans do things the wrong way. You try to sell us American-made chairs so high that the Japanese can never sit in them (our feet won't touch the floor), instead of going over to Japan and finding out what the Japanese can use and will use.

"You put four golf balls in a package, and they don't sell. Why don't you find out the reason? The Japanese don't buy things packaged in fours. Four means death. And so, they are not going to buy golf balls, packed in fours."

Mr. Kobayashi then said that the Japanese on the other hand, come to America, find out what the Americans want, and manufacture those goods for sale in America. If Americans want smaller cars, they will build small cars. If they want gas-saving cars, they will build gas-saving cars.

I think the private sector has a lot to do. As Ambassador Mansfield observed, the American businessman must return to that period when he was appealing directly to the consumer.

I see my time is up.

The CHAIRMAN. And gentlemen, you are not going to be given a chance to reply, for the moment.

Mr. YOUNG. Thank you.

The CHAIRMAN. Thank you, Senator Matsunaga. Senator Pryor?

Senator PRYOR. Thank you, Mr. Chairman. What, in the next round of talks—and this basic question was asked of Ambassador Strauss the day before yesterday—what is our basic leverage our country carries into those talks that we can use? Or what leverage do we have that might be respected?

I would like your comments on that. Mr. Pratt first?

Mr. PRATT. All right. We have some serious leverages, some important leverages that we have always had. And as I said before, I attended the beginning of the round at Puente del Este; and I think it is interesting to know that I was struck by the fact that even in the current set of circumstances that we are bemoaning here, most of the rest of the world, without any doubt, still considers that any leadership in this sort of thing must come from our country.

I must have had 15, at least, medium-sized to small countries, particularly after some very difficult negotiation sessions where they were arguing for their interests versus maybe our interests or some others, come quietly up to me and say: You people, tell your Government leaders that they still have got to give the leadership that Uncle Sam has always given in this area. Don't be too timid; don't think you no longer have the leverage.

I was quite impressed and surprised by that. We did achieve at that round, I think, an outstanding result, at the beginning of the round in Puente del Este. We got on the agenda the things that we felt were important, although there was a strong trend of disagreement from most of the rest of the world. Again, I think you would be pleased to know that I have never seen our Government do a more effective job. Almost every Cabinet department was represented there—the three Cabinet secretaries and a number of high officials from other members of the Cabinet; and it was an integrated unified effort with private sector people like myself involved.

And this is still the biggest market in the world, and that is the ultimate leverage. If we ever got back to the place where the whole system fell apart and everybody closed their doors, we would have the best market io the world left Japan would be dead, who has to export to live. They know that.

They know that—as I mentioned earlier, perhaps before you were here—this series of—you know we are in an unbelievably fascinating situation. It is a little bit of an exaggeration, but we almost are in a situation where every nation in the world has a favorable trade balance. Now, how can that possibly be true, because our own—is so big it offsets all of them?

Now, that is an unbelievable situation. It is something that gives them—it is like a bank you know; if you and I owe the bank a small amount of money, we worry about it. If you owe them a huge amount of money, they worry about it.

And so, we are in a situation now where we have more leverage perhaps than we have ever had, and I think what happened at Puente del Este was an indication of that.

I think we have a team, in the USTR and Commerce and others, who are becoming effective and who are aggressive in these negotiations. I believe we have a chance for some meaningful results. We are not going to solve all of our problems, but the important part of the whole picture.

Senator PRYOR. Mr. Young, you have a plant in Japan. If the Congress passes what is considered to be protectionist legislation in this session, what would be the retaliation, do you think, against your particular company or others doing business in Japan or with our other trading partners—specifically Japan and then other partners?

Where would that retaliation first come? In what form? What phases might we expect?

Mr. YOUNG. That is an interesting thing to speculate about, and I can't do more than do just exactly that.

My guess is that the Japanese businesses are so dependent on the United States market that I think, unless we did something really outlandish, they would have quite a difficult time retaliating against what we have done.

I believe, from the many contacts I have—including the chairman of our company, David Packard, who led an eight-person wise man's group last year of Japanese and Americans, looking only at this trade policy—the Japanese know themselves and believe themselves that this level of trade imbalance is a big problem. It is the single biggest problem they have because it affects their most important strategic relationship. I think it would hurt them to do something like that that was too sharp, but they know that this has to be corrected. It would be more profitable if we could get commitments from them that are made on a more voluntary basis, and I would hope we could just accelerate that but hold behind that the fact that we are serious, that it really has to be rectified.

Mr. PRATT. If I may make one point that I think is important here, I have observed over these last few years that I think protectionism is sort of like nuclear war. Once you go to nuclear war, it is all over. It is the threat of nuclear war that is of value. It is the retaliatory threat that nobody ever conceives of.

The same thing is true of protectionism. Once you take a protectionist action, you have used up the value of that threat. And I think the way we have been able to achieve the recent negotiation advances we have, like in Korea with intellectual property, was by that. I am not against retaliation, and I think we do have to retaliate; but general retaliation legislated, I think, is ineffective and likely to cause more harm than good.

The threat of retaliation is better than retaliation, and I think our Government is learning to use it more effectively than they ever have before.

Senator PRYOR. Thank you both. I think my time has expired.

The CHAIRMAN. Thank you very much. Commenting on that, I frankly think there are times you have to retaliate or they are not going to take you seriously insofar as taking down barriers to our products coming into their countries, and we have a number of those.

And I think in many instances there would be immediate retaliation back in an escalation, but in others there would not because we are by far their number one customer; and I don't think they are about to run off their number one customer. They would find some way of trying to work out a compromise and adjustment in that regard.

You made a comment earlier about how you thought they had done well at Punta del Este. I think they did, too, insofar as getting those items on the agenda, some of them that had been resisted for a long time. But my next concern leads to the point you made that almost everybody has a trade surplus but us. We are the ones that sop it up.

Through all the 1970s, world trade expanded substantially. In the 1980s, it flattened out; and if it wasn't for our enormous deficit, it would take about a five percent drop. That is what would have happened to world trade.

But I note the other thing insofar as the work program for GATT and the negotiations, that was supposed to be set by December 19, and that date has come and passed. And what concerns me very much is that in these negotiations, these people with trade surpluses are not going to be in any hurry to change the status of what they now have.

And finding ways to put the pressure on to get those trade talks going is not going to be easy.

The other one I note is that you made the point about your never having a job layoff; and that is an incredible record. That is marvelous. And I don't know if you fellows are the best ones to ask this question or the worst ones to ask this question; but I get deeply concerned about skills that are no longer useful.

And I think one of the most denigrating, debilitating things that can happen to a person 40, 50, or 60 years old is telling them that they have no productive role to fill in society any more. I don't think we can accept that from the individual's point of view or from the nation's fiscal point of view. And we have not been very good in this country, it seems to me, in trying to replace those skills, teach them new skills.

What we have tried has been terribly expensive. Now, you gentlemen have been able to keep people employed. I don't know if that is just because you have been a remarkably good growth industry—that is part of it, I suppose—or is it something different you have done in job training and trying to replace skills and teach new skills that is different that could be helpful for us?

Mr. YOUNG. I think maybe the answer is some of both of those. We have enjoyed pretty consistent growth rates being part of electronics over the last 30 years or so, and there is no question that we enjoy a very different environment than the cyclical nature of automotive or steel or something else. So, I don't pretend we are some magic pentagers who have found ways to avoid those problems.

On the other hand, we do have continuing difficulties with training. I have worked with Hewlitt-Packard now for 28 years, and my personal career has spanned four complete technological changes. I started with a vacuum tube; we went to transistors, integrated circuits, and now very large-scale integrated circuits. And we have had to find ways over this entire period of retraining, because it shifts the whole technology of packaging and assembly and the way production work is done.

And it certainly affects dramatically the kind of work engineers have to do and the kind of learning they have. We are lucky in Silicon Valley in being next door to Stanford.

Part of the foundation of Silicon Valley and Stanford goes back to this partnership between academia and companies, and we have worked out some things that have been most interesting. Television training, for example; 20 years ago you could take classroom instruction at Hewlitt-Packard from Stanford, or you can go over there; or you can take it by tape elsewhere in the United States on a delayed basis with a local tutor for credit.

And guess what? The people who take it by tape score significantly better in graduate engineering education than going to class. So, it is not a mail order degree.

And we do the same kind of thing. We use these community colleges. Now, your father used to have the same job, as you said—93 has been a farmer for a lot of years—but I think our kids are probably going to have five or six different careers, very different things to do.

Community colleges, for so many, are an important way to recycle them. And yet, if you look at the way budget responses go to those, you will find that if you are just coming out of high school, you get most of the support and the support that goes for retraining, recycling, repreparing people is very much lower.

Our Commission made, I think, some very important recommendations about this kind of area. So, I think there is an awful lot that can be done.

The CHAIRMAN. Mr. Pratt?

Mr. PRATT. Mr. Chairman, fortunately for us as well, one of the best decisions you can make is what industry you happen to be in, and some industries unfortunately do not have nearly as many opportunities at a particular time as others. So, we also happen to be in some industries which are in a growth phase and where there is opportunity for innovation and growth, although in our case we are somewhat diversified.

We also have some industries which are not in that category. So, we have been forced to face the experience of downsizing some; and since we are a diversified company, we have been able to do that by moving people, which means we have had to retrain. And there is a lot of capability for retraining.

Almost all universities are specializing as a side issue in courses of this nature; retraining executives and people in the community colleges. So, there is the opportunity for this. We do need to do it better. That is the enormity of this whole problem we are facing.

We haven't talked much about it, but I think John had it in his testimony—the whole issue of the education system in our nation and whether it adequately trains our people to be the right kinds of workers.

I think that is a meaningful problem which I am sure the Congress is focusing on, as is the Administration. So, almost everything we touch has an impact on this issue that you are facing, which is why it is such a difficult one.

The CHAIRMAN. Senator Durenberger, I apologize; I didn't see you come back in the room, and I don't know how I could have missed a man of your presence coming in the room without my knowing it. [Laughter.]

Senator DURENBERGER. Mr. Chairman, I just feel great being back here in the same old seat I occupied in 1980. I haven't progressed at all. [Laughter.]

I still have Armstrong on one side and Wallop on the other, and we are still debating some of the same old issues. Well, it beats what we are doing in the Intelligence Committee, anyway. [Laughter.]

I have a prepared statement, which differs from the one that I just delivered; and I would appreciate it being part of the record. It includes my expressing my appreciation to both Mr. Pratt and Mr. Young and Bob McNeil and others who are here.

I think the value in their testimony is not in the specific, but in the overall content, which in effect says that the problem that brings us together—the very large problem—and John Young ended up talking about educating engineers through tapes they play in their cars to and from work when they want to concentrate on something meaningful, to themselves.

And yesterday the Secretary of Education was saying to the Labor and Human Resources and the Budget Committees that this isn't really what I would like to be doing, but you know, I have to. And what he is doing is cutting the national investment in education.

And I was struck by something Mr. Pratt said in response to that. I wish we still had the Don Reagle chart. I take it he is going to be a regular contributor to our education here in this committee; but that is a great chart because Pat Moynihan and I were not here on Tuesday, Mr. Chairman, although I wish we could have been; but we were in Minnesota where they try to look ahead of problems like you are doing here. We were at a conference on the productivity of the children of the "baby boom" generation.

And we have somehow figured out that the "boomers" are so big in number and are having so few children that we have got some real problems facing us in the country, in just retiring the "boomers"; and the answer is the same answer I heard from both of these gentlemen; and it is productivity, and how do you get productivity? You get it through an investment in education and in investment in American enterprise. And I take it those are the subjects we are dealing with here.

But one of the problems that keeps striking me is, as Ed Pratt said, Government keeps doing things the same old way in reference to that chart. He is panicked by the deficit. If this were a company, we would be doing something about it.

Part of the reality is that this ain't a company; this is a society, and the business and economic issues, as Bob Strauss told us the other day, are always on the back page of the paper, and you can't understand the acronyms for the things that Pfizer and Hewlitt-Packard are buried back there; and they have a meaning to a few people, but not to the people of the country as a whole.

I mean, it comes after the sports section and the political news and everything else. And we don't seem to have any other way in which this company can come to conclusions. We do have one thing that isn't in either of your statements, and it is election.

It seems to me that the business side of this company—the employers of most of the people in this country—are things that perhaps they could speak to more generously than they have in the past, and that is what we do at election time.

You know, what is missing in our society? I sense that it is a lack of debate on values. Now, we all talk about living within our means. Mr. Pratt said that if this were a company, by God, we would balance our budgets and so forth; and yet, I don't know how far in debt Pfizer is. I know that I have never lived within my personal means. I know that the whole country is $7.5 trillion in debt.

I know that that whole red thing there, you know, did not go into building new plants in Puerto Rico or in a lot of other places. It went largely into what has been $500 billion in takeovers and mergers in the last three years. It went into LTV, a very good defense company, you know, that picked up a steel company. And now, today, we have got 30,000, 40,000, 50,000, or 60,000 people out of work.

And Lloyd talks about people in their 50's and 60's, or in their 40's, out of work, cut off, in my State and Ohio and so forth. They go bankrupt and they just walk away from the thing, and the Pension Benefit Guarantee Corporation picks this thing up; and everybody's pension costs go up. And we don't have any place, it seems to me, or any way in which this society comes to grips with all of these issues and brings them all together.

And I suggest that it has to be around election time and that maybe the business community ought to speak to the lack of debate at election time around values and around principle.

All we do is talk about whether or not we felt better last year than today and are going to feel better next year. We had a bunch of elections run on feelings, and they get taken away from us when people feel worse than we do—they take our seats away from us.

And that is what I face in 1988. On trade, I have to go back out, and I have got to make the decision. You know, am I going to pit the auto workers against the consumers who are paying more to keep Japanese autos off the market? Should I pit the timber interests in my State against the folks that get their hydropower or their natural gas from Canada?

I could do this thing all day long, but where would it get me? Would it solve any of those problems? I don't think so. It seems to me there is a lack of pressure from institutions on the business side or the other side—but particularly business since you represent it—pressure for those of us in the governmental process to speak out on the larger national issues, the interrelationships between education and a lot of these other things. Just say something about $500 billion worth of mergers and unproductive investment and things like that.

I am just curious about your general reactions to getting above the specific and talking about Government in the larger sense of when we come together as a society and debate these issues in elections. Do you feel the absence of issues in your elections? Do you think it is just personalities? And don't you think that is part of our difficulty here in coming to judgment?

Mr. PRATT. Yes, I would agree with that, Senator. I think most of us feel, from our point of view at least, some of the major issues don't really get into the picture the way they should. In fact, I don't know whether you were here at the time or not, but both of us talked about that. You know, I said at the beginning of my testimony that the one single thing that we thought was most critical to deal with this issue was to give it a higher priority. And how you do that, all the things you say are right. We should speak out more, and we are trying to do that.

Business is producing publications and circulating them. We are writing in almost every quarterly report we send to our shareholders and in our annual report; we have now taken to delegating several pages to talk about these issues.

So, wherever we can, we get this important issue, in the final analysis, to jobs. You know, paying low taxes—we all like low taxes. Low taxes are not as important as having jobs or any other issue.

So, we are trying to do this. I don't think we have had the impact obviously that we would like to have. We are here trying to do that, too, with all of you. I agree with you. I think in the final analysis, a democratic society will react to the things it thinks are important, and it is up to us to try to help them see—to the extent we have insight—what things really are important to their own standard of living.

Mr. YOUNG. I agree with that. Perhaps you can be more helpful than we can in making sure that the 1988 presidential elections become a forum for discussing real issues. Maybe we all should dedicate ourselves to making sure that the television fora and so forth are really set up to do that. Unfortunately, some of these issues cannot be packaged in the 20 second modules that the media deals in, and that makes it kind of a practical problem; but it doesn't mean we shouldn't try.

I think there really are some very important fundamental issues that the American public would benefit from understanding more thoughtfully.

We have taken being competitive for granted in this country. It is a real inflection point. Change of view. You have to really think hard about the proposition of having to earn that standard of living we have every day. It doesn't come to us by some natural right. I think the American public simply does not appreciate that fact.

The Chairman. In our next round of questioning, the order will be—of those Senators remaining—Senator Packwood, Senator Rockefeller, Senator Matsunaga, and again Senator Durenberger. Senator Packwood?

Senator Packwood. I don't think Mr. Pratt has a chance to complete an answer to that question.

The Chairman. Oh, I am sorry.

Mr. Pratt. I was just going to add an old saw, I guess, and yet I happen to believe it. I do think that the American public—I think we have done some wrong things here and maybe not done some things we should have done, to where we have a problem. I think it is not going to be painless to solve that problem, and that I think is where the hair gets short.

And I think the longer we wait, the more painful it is going to be to solve the problem. But I do say, I think—and as I say, to repeat the old saw—that the American public properly led are willing to do what has to be done under difficult circumstances; and we sometimes underestimate that.

Senator Packwood. Mr. Young, in response to a question of Senator Heinz, you were talking about Brazil and open markets; and you and he bandied about $20 or $30 billion. Is that your rough estimate of what we might be able to do to reduce our deficit of all the foreign markets that are open to us?

Mr. Young. I think that is the Department of Commerce——

Senator Packwood. Actually, if you were at $20 billion now?

Mr. Young. It is some number like that.

Senator Packwood. Now, in addition, could we improve the situation by improving our domestic laws, or did you mean—assuming a perfect world, assuming good capital formation laws here and a good trade policy and open markets—we are still going to have deficits of $100, $110, $120, or $130 billion?

Mr. Young. No, I didn't mean that.

Senator Packwood. All right.

Mr. Young. I mean not to look for market distorting practices to collect the $170 billion. I mean, we are talking about those exchange rates being way off.

Senator Packwood. Right. So, you are talking about the market distortion practices being worth $20 to $30 billion.

Mr. Young. Yes.

Senator Packwood. And not necessarily our capital gains laws or something else. All right.

Now, Mr. Pratt, you came very close, I think, to posing the fundamental question. You said that there are some industries that, even given the fairest of circumstances, may not be able to compete in the world economy; and at that stage, you said I hate to say it, but we may have to consider protection. Did I phrase it roughly right?

Mr. PRATT. Either protection or deciding to get out of those industries. If it is an industry that, for national security or other reasons, we can't afford to——

You know, obviously, the economic philosophy is that every country can't make everything.

Senator PACKWOOD. You are right. Now, let me ask you——

Mr. PRATT. There are some industries that we are probably trying to stay in that we ought to get out of; and that is where you get readjustment, retraining, and other things. Every nation has to face that. I was only saying that there may be some industries where, because of whatever—the economics, lower labor costs, the fact that technology is more broadly available now—even critical industries we can't afford to get out of, that we can't compete on a normal basis, we may have to take some undesirable and unusual steps in those. I think that is possible.

Senator PACKWOOD. When we were considering ratification of the Israeli Free Trade Agreement, we had a series of witnesses, many of whom represented industries that did not want a free competition with Israeli imports. They are a very small part of our overall trade, but still in some areas they are a little more significant.

So, the witnesses came and it was, no, they didn't want free trade with Israel. They were worried about jewelry or leather or whatever. One witness that day represented both the apparel and the textile industries, apparel being the coat and textile being the cloth. And I asked him: Given a perfect world with open competition, could you compete both in the United States and in the world in apparel and textiles?

And he thought for a moment, and he said: In apparel, no; in textiles, yes. He said: I do not foresee in the immediate future, on the foreseeable future, apparel becoming so capital-intensive and automated that we can compete. In textiles, it is becoming so, and we can.

Does that then pose the question about: Are we going to keep an apparel industry in the United States? And that is the type of thing you are talking about.

Mr. PRATT. Yes, it is.

Mr. YOUNG. Could I just say a brief word about that? I don't know much about the apparel industry; but it was during our Commission work that we had a very interesting opportunity to think about that. We were talking about ways of using that technology more effectively to compete.

I mean, obviously, we couldn't compete in apparel if you are thinking about having a person sewing for 40 cents and one for $40 an hour; but obviously, you couldn't compete in a lot of industries. So, how do we use technology to do this better.

Well, the Draper Laboratories, one of the Federal laboratories at MIT, was working with the textile industry on a sewing robot. And I learned to my surprise that putting the shoulder in a suit is kind of the acid test for sewing or seamstress work. And subsequent to our Commission ending, I have learned that that project has been completed.

The robot sews very, very well, and so we may have the beginnings of a renewal of these industries. But now, the problem changes; it changes for a very interesting reason.

I also got into a little discussion about textile machinery. When you think about these new weaving machines, 25 of them can be tended by a single individual. Now, whether that individual makes $4 an hour or $20 an hour, it can't be that big a deal, and it isn't. But whether the capital costs for the $100,000 or $250,000 worth of machines is 10 percent or 20 percent, of course, absolutely controls the economics.

So, we sort of push the problem around, and we have got to always keep our eyes on all of the issues that come up.

Senator Packwood. Business, of course, is always reluctant to step on somebody else's turf, and there is no point in saying we don't need that business if it isn't your business. All you are going to do is pick up an enemy and certainly no friend. One of the other groups that testified on this Israeli Free Trade Agreement was the California avocado industry. They don't want imported Israeli avocadoes.

But there I had to think to myself: Will the diet or the defense of this country be injured by the absence of the avocado? And it won't; but you are not going to get a single business leader to say: Well, that is one we can let go. I don't know where they are all growing in California, but I will wager there will be two or three Congressional districts that will fight tooth and nail to say they are critical to the defense of the country. [Laughter.]

Mr. Young. These are exactly the petitioners I had in mind, between here and May, that you are going to have to make some important judgments about the competitiveness issues. I am just suggesting you do just as you suggest: look at it from a real competition point of view.

Mr. Pratt. You might not expect us to pick out the avocadoes to sell down the river, but I don't think you will find many businessmen who will deny the fact that industries have to have the right to fail. And in a free enterprise system, that is the basic tenet of it.

However, there are some industries that we will not allow to fail, and they are special cases, and not too many of those hopefully.

Mr. Young. I think at the business roundtable, Jimmy Robinson will be here in a few more days, and one of the things we have been working on are some adjustment things, and you will have a chance, I think, to joust with Jimmy about some of those ideas on how to have an adjustment mechanism and a people mobility incorporated with that.

Mr. Pratt. We have had to have that even before international competition. Just competition within the country has obsoleted industries over the history. That is not a new thing for us to cope with.

Senator Packwood. Let me say something to Senator Bentsen. I have complimented him on the way we are starting out the hearings with just one or two witnesses a day that we can plumb in some depth, instead of panels of five apiece or 40 or 50 witnesses a day. The two of you have been two of the best witnesses I have ever heard here. You are savvy and you are very senguine in not saying that all businesses are your businesses; and you have surmounted the problems, and therefore, they can surmount the problems.

It takes a very broad-gauged person to grasp that, and the two of you are to be complimented.

Mr. **Pratt**. Thank you, Senator.

Mr. **Young**. Thank you, Senator.

The **Chairman**. Thank you, Senator Packwood. Senator Rockefeller? And incidentally, I think Mr. Robinson is scheduled to testify on Febuary 3.

Senator **Rockefeller**. Thank you, Mr. Chairman. The reaction of American business to adversity. There are a lot of fits and starts that one hears and reads about—the General Motors layoffs and many quite strong reactions.

The Japanese have gone through some rough times recently. They had a very bad third quarter in 1986, and the fourth quarter doesn't look much better. But they seem to have worked it out, because of the relationships with their banks and the government and industry. They ride out business cycles. They keep on investing. They keep on innovating. They keep on doing the basic work that is going to pay off six or eight years down the road.

There is an instinct and a coherent national policy that allows them to do that. We don't have that here.

Now, on our side—take semiconductors in the last recession—there is an instinct on the part of corporate America, I think, sometimes to make the wrong reaction and cut where you shouldn't. You retrench where you shouldn't. You slow down on R&D, or you do certain things which clearly can be justified in the sbort run and which probably cannot be justified in the long run.

I am quite frankly struck by the degree of pessimism that, particularly you, Mr. Pratt, have put forth in this discussion. What we can do about that? What can American industry do about that perticular problem of reacting to adversity?

Mr. **Pratt**. I think I would object to that—I didn't mean to be pessimistic. I would say that what may have given that impression is that I am tremendously concerned about the state of the economic problem the nation faces and concerned that we haven't seemed to address it more aggressively.

I am not pessimistic. I think, however, that we are realistically going to face some more difficult times than we have had in recent years, and I have great confidence in our nation and its people. I am not pessimistic. I think it is realistic to say that we cannot recover from the numbers that the Senator showed on his chart that easily. And it is not pessimistic to say that that is the case.

I would say in passing that I served on the board of one of these companies that comes into all these discussions—the General Motors Company. I think it is a failure to understand what that management has done and has tried to do, to imply that they are doing short-term things.

As a company that doesn't have these problems, frankly I admire the approach they have taken. They have done what I think any red-blooded American would want them to do. They, in effect, have bet the company on the aggressive actions that they——

Senator ROCKEFELLER. I don't mean to pick on General Motors; I am trying to get at a broader principle. The way that the Japanese handle business retrenchment as opposed to the way we do it—are we changing with respect to research and development?

Mr. PRATT. I think it is, in general, an unfair judgment to say that we immediately cut out the important things and they don't in times of trial. I don't think that is a proper judgment of what happens to American industry. Are there some cases where it happens? Possibly so. I don't think it is a general reaction, and I am using General Motors as an example.

The fact that you may have to lay off people in a cyclical industry, it is true, that the Japanese have a whole different cultural approach to that, which is tied in with the way they are financed and with the role their government plays and a lot of other things. But I don't think that it is fair to say that—as a matter of fact, the Japanese, facing some really difficult times, are starting to face cutbacks and layoffs of people, too, and they are not going to be able to avoid that.

So, my judgment is that you are probably overdrawing the comparison between the two.

Senator ROCKEFELLER. Then, let me refine my judgment because I don't mean to. I was referring less in fact to layoffs and, therefore, I think the GM thing triggered that reaction in your mind, than I am to what I would call fundamental patterns of investment—what you have to keep on doing regardless of a business downturn in order that, when that downturn gets better, you will be in a position to compete. That is, fundamental investments that you have to keep on making, regardless of business cycles.

Mr. YOUNG. I think you cited the semiconductor industry, but it was really the recession before the current one that is kind of interesting. While the semiconductor people, with the retrospective of their own management, said we made a big mistake—this was in the late 1970s—we did cut back on our investment. It really created a market window on the up side because we didn't have the capacity, and it gave an opening for the Japanese to come in, and we shouldn't have.

If you will look at the current recession—and believe me it is a serious one that has been going on for the last three or four years—you will find companies like Advanced Micro Devices which has incurred huge losses. His R&D spending is close to 20 percent of sales, and he is just driving that thing through here as far as his capacity to finance that will go. That is a very different response.

I really think that is more typical these days. The low point, I think, of industrial response in the U.S., the reactions to quality and some of these kinds of things, probably occurred six and seven years ago. I think if you will take a look at some of the quality of new cars today, if you will look at attitudes about quality, about forging teamwork on the factory floor, I mean there is a rennaissance out there that we don't get enough credit for in American business.

It is not that there probably aren't still things to do. And some of them are probably still out playing golf with Treasury officials, but believe me——

[Laughter.]

Mr. YOUNG [continuing]. The bulk of them are hard at work, you know, fundamentally reforming their businesses.

Senator ROCKEFELLER. I understand that and I respect that. And I think that there are examples of that even within the steel industry. I think on of the truly extraordinary industrial documents is something called Appendix E of the Wheeling Pitt Steel Contract that was ratified a couple of years ago, where there is a fundamental sharing of responsibility in the workplace right on up to the board room, concessions on all sides, an entirely new approach towards cooperation, which I guess would lead me to the thoughts that you might have on the steel industry.

Mr. PRATT. I would think so.

Senator ROCKEFELLER. If the laws of economics continue unfettered, then national security will be put aside and steel will be made elsewhere, perhaps not even in Japan but in Korea and other places. Is it that we come down from eight steel companies to three and that is really what this country is looking at 10 years from now, and that is proper and appropriate?

Mr. YOUNG. I am not knowledgeable enough, other than to repeat conversations with those who think they know that capacity of reduction is going to happen. But I am not sure the Pension Guarantee Trust Company can handle it. I think ultimately there is going to have to be a dramatic rescaling of many of these things. It is not bad; it is just very painful. And that is why I think these adjustment ideas and to be sure we don't put the whole burden on those we feel are able to cope with this kind of a problem.

The CHAIRMAN. Thank you, gentlemen. Senator Riegle.

Senator RIEGLE. Thank you, Mr. Chairman. Mr. Pratt, earlier in your first comments, you touched on some things in passing that we have not gone back to; and one that you touched on was—if I heard you properly—the area of corporate takeovers. Would you elaborate on that a bit, to the extent to which you think that is or is not a major problem today and any suggestions you might have on that?

Mr. PRATT. If I might bond it just a little, I think there are two that in a way are kind of related. That is what I call tort reform, the liability insurance crisis, and the takeover issue are kind of peculiar to our country. They are not going on in other countries. They are, I guess, a function among other things—and I am sure I will step on a lot of toes here of a number of lawyers that we have in our country and how effective they have become at building great financial success—but they are a serious problem.

They are both serious problems. Fortunately, both Mr. Young's company and mine have, as far as I know, not yet been the focus of takeover attack; but many, many companies that I am familiar with have, and I think it is on balance a seriously destructive economic impact on our society.

And having said that, and I think almost all businessmen, except the few who are the raiders, feel that way. And the baloney that you hear about its being a way of cleaning out inefficient management may be true in one case out of very, very many, but it is baloney; and it is a story that they have been able surprisingly effectively to sell to the media at least.

But the amount of money and effort and diversion of management time—even companies like mine, and I shouldn't say this I guess—somebody is probably listening—feel threatened. We are still spending a sizable amount of time making sure we have done everything we can.

And how many of our companies, in order to defend themselves, have practically destroyed their ability to be financially viable in the future? So, I believe that the rule that we can all have free enterprise—we can't have that.

We operate, whether it is international trade under GATT rules or the SEC rules—in our case, the FDA rules. We know by now that a free society requires rules in order to keep a reasonable balance. I think the rules need to be modified here so that it is not possible to walk in with no money and put a company into complete disruption as you try to buy it with its own assets. This is outrageous and destructive and needs to be changed.

And we have been working with governments at the State and national levels to try to do the same thing about liability. Doctors are refusing to take cases. Local government administrators can't get liability policies and refuse to serve. In our case, it is hard to get directors.

The whole system is being seriously eroded and it is not being done in other countries. So, these are two things that we ought to be sensible enough to make reasonable changes in the ways the laws that govern these are handled.

And it would be a meaningful impact and increasing our competitiveness, I am sure.

Senator **Riegle**. The reason I asked that is because I am going to be heading the Security Subcommittee on the Banking Committee for this Congress, and we are about to move in on this issue of insider trading and what is taking place. I would like today to ask you, if you would—not at this moment—but provide for me, both of you, whatever recommendations and ideas you have that relate to changes in, as you say, rules or laws or procedures that would serve the public interest. I really would like to have that in an organized way; and in fact, we may in turn invite you to come and testify at some point because that issue is going to be a very large issue in this Congress, coming off the Boesky case and other things.

Earlier also, you mentioned that there may be some industries that we would decide are critical that, given the nature of the new world economy, can't make it because Adam Smith doesn't quite work the way we thought it did in the old days.

Are there any particular industries? You have had a discussion with Senator Rockefeller on steel, but are there any particular industries, from either of your vantage points, that you feel are really in serious decline and caught in these international cross pressures where they cannot sustain themselves. As a matter of strategic national interest—which of these industries should we examine and what steps should we take to fashion a unique way to keep those industries viable for our own future?

Mr. **Pratt**. That is like a lot of things when you get to the details, it gets tougher; but I guess you might say in a sense that is related to this great word that we have learned called "targetting." Foreign nations, particularly Japan, have picked out industries which they thought were important to them, for not necessarily security reasons in their case, but their economic future; and they have done whatever was necessary to make them successful.

I guess in a sense every nation has to do some kind of targetting. You have to decide what things are critical to you and take that into account as you make your policies.

There are obviously lots of possibilities here. I would think with a nation in our position and the defense of the world that heavy industry that underlies our weapons program, I can't conceive of our having to depend on the Japanese for all of our weapons sources or the technology that goes with that. So, heavy industry, it would seem to me, is part of that, as well as some of the high tech industries.

I can't conceive of us letting all of our electronics capability go to the Japanese. Many people are concerned about that.

Senator RIEGLE. Did the Fujitsu intention to purchase Fairchild fall into that category in terms of the matters of concern to you?

Mr. PRATT. I will let John talk about that. That is in his field.

Mr. YOUNG. I don't know about that one. It is alleged, at least, that certain circuits manufactured by Fairchild in the short term are government-related and that that could well be an issue. But I think you should watch for a report coming out shortly from the Defense Science Board in which they have made a rather extensive study of the relevance of our situation in semiconductors to our national defense.

I personally am very concerned about the status of the semiconductor industry. It is absolutely fundamental not only to the competition in that area, which is important in itself, but so many things relate to that—all the computers, the communications, the very fundamental cornerstone industry.

And I think that it has the peculiarity that its processes for advancement in the future depend on certain circuits, most notably memory circuits, random access memories.

The Japanese, of course, have got 80 percent of the business, and U.S. manufacturers have gone out of that business now. The official finding of the Government investigation is that dumping has really caused an awful lot of that to happen. So, that puts forward a rather interesting situation, and I think it is one that is probably one deserving of careful analysis and support.

I am very concerned about maintaining our cutting edge in semiconductors.

Mr. PRATT. This is not a new subject. Bob McNeil passed a note to me to remind me that, of course, this issue has long been considered in our Government. There is a clause in the trade law, a national security clause, that allows for investigation as to which U.S. industries are essential to the security as part of the trade practice.

I was just going to finish up by saying we have had a number of examples already which maybe we are not completely clear on this issue, but it certainly was underlying; I think the automobile restraint activity was one of those that had implications of this kind. I think the "bailing out" of Chrysler and Lockheed were similar ones. It is interesting that the majority, I think, or the average businessman has a knee-jerk reaction against this sort of thing. I suspect maybe we need to be a little more thoughtful about it.

It was interesting that a poll was taken of business leaders at the time of the Chrysler example, and they voted almost unanimously that the Government ought to stay the heck out of it. I am not so sure that the Government didn't do the right thing there in the Lockheed cases; they are not that simple.

Senator RIEGLE. My time is up. Thank you.

The Chairman. Thank you, gentlemen. Senator Matsunaga.

Senator MATSUNAGA. Dumping practices are one of the big problems for American business. Since Mr. Pratt stated that retaliation is like engaging in nuclear war, how are you going to deal with a dumping problem such as that, which is imposed upon our agricultural producers. In the case of sugar, for example, the European Community provides a subsidy of 14 cents a pound to sugar growers, and the cost of production in Europe runs up to about 24 cents a pound. And yet, they dump that sugar in the United States at 2 cents to 4 cents a pound. Now, what would you suggest we do to remedy a situation such as that?

Mr. PRATT. I don't want to overplay the analogy to the nuclear war, but the only point I was trying to make is that normally, using your ultimate weapon, is more effective as a threat, rather than an actuality, and that once you have used it, it is all over.

But the threat of retaliation is more important than retaliation, but I agree with Senator Bentsen's comment that, yes, we have to retaliate at times; certainly, we do. And I suspect we will gain a lot more by the times we threaten to retaliate and negotiate a better answer than we will by retaliation.

But you are quite right. In order to convince people that you are going to use the strengths that you have, you are going to have to do it every once in a while. No, I am not against that. I said earlier also that we need to negotiate very strongly on the world scene, and that involves using the threat of retaliation; that is the only way you negotiate finally, in most cases.

I guess it is preferable to negotiate by being willing to offer something, an advantage to somebody, in return for an advantage, rather than to trade threats; but there are times when that isn't possible. So, you have to retaliate at times. I think the more often you can use it effectively in negotiations, you are better off.

Senator MATSUNAGA. As you well know, the European Economic Community refused to join the International Sugar Agreement. If they had joined, I think we would have had a solution wherein the entire world of consumers would have benefitted by keeping the price of sugar stable. Did you have a comment on that?

Mr. PRATT. Yes. I was just going to say that, as I listened to you, the problem is that you retaliate; and then you damage them and they damaged you, and you haven't helped each other. You know that is the problem with retaliation.

If retaliation, indeed, does not remove the ill that you had, then it hasn't accomplished anything. That is the problem.

Senator MATSUNAGA. I am in agreement with you, but we are looking for specific solutions to these specific problems and what needs to be done by way of legislation to meet the pending problems. One of the suggestions you made, Mr. Pratt, was that in the new round of trade negotiations, we include services. Now, how would that affect our trade balance? Would it be a minus or plus? And if so, how much?

Mr. **Pratt**. The reason we need to include it is that it is becoming a growingly important part of our economy, and we are the world leaders in most of the areas that come under services—banking, insurance, many other things that are service functions—that generate a sizable amount of favorable balance of payments for this nation.

And it is indeed a growingly important part of the economic scene. The reason why it is important to put that in the trade negotiations is that it will suffer the same kinds of attacks and, in many cases unfair ones, as many nations try to carve themselves a role in this growingly important area. And we need to have, if possible, agreed-upon rules so that that playing field can stay level, just as it does in the trade. That is the importance of having services in there.

It is important to us because it is relatively more important in our nation, as a part of our economic activity, than it is in other nations. Therefore, we had to argue. They would rather have complete freedom to play that game as they want. We say no; in fact this was an interesting little phrase that came in at the Puente del Este meeting. What we are saying to them is that we want to negotiate with you where trade is in the picture, as well as intellectual property rights or investment rules or services. We are not just talking about tariff versus tariff.

Now, they fought that because they didn't want us to work these new areas which are important to us; and that little phrase came up and was used in Puente del Este. The nations arguing against this said they didn't want to agree to an "eye for a tooth," which is a very descriptive phrase. We were saying we wanted to negotiate for trade, on one hand, versus intellectual property, on another hand; and that is an "eye for a tooth," which is a pretty descriptive way of calling it. That is the importance of that.

Senator **Matsunaga**. Do you have any figures as to whether our trade balance would be improved if we included services?

Mr. **Pratt**. The services are an important part of our favorable trade—the favorable part of our trade balance now; and to the extent that we lose any of that, it would be an unfavorable result in the total picture.

And it is many billions of dollars favorable now, and that is what is at stake. I don't have any exact figures now, but it is a sizable impact on the balance of payments.

Mr. **Young**. I would add that it isn't fair to say that tradable services today are not a big issue; but the point is that they are going to be in the future. And it is important to get these markets open as opposed to letting the same things get repeated that happened in a lot of these manufacturing sectors where they were able to do these market closure things and systematically exclude some of the things we are most competitive at from beginning to develop.

Secondly, they are not that separable. If you think about Japan particularly, and you think about why there were so many joint ventures, why are there so many licensing agreements? Well, you could say from one point of view that maybe they were smart in doing it. Well, I think the record shows that, by controlling the ability to invest, controlling the ability to have a wholly owned activity and so forth, you caused more licensing things; you caused the technology transfer that in fact accelerates the building up of these businesses. So, it is just another part of that kind of a systematic national plan to create a competitive advantage.

I think it is very important to understand it for what it is and head it off at the outset.

Senator MATSUNAGA. The figure I have is that including services in the new round of trade negotiations would reduce our trade deficit by $40 billion. I just wanted to check to see if the figure I got was right. I have other questions, but I note that my time is up; and I wish to commend you both. I think that you have contributed greatly to our thinking and hopefully to specific legislation as a result of this great problem which faces not only the Government, as such, but our business community especially.

Mr. PRATT. Thank you.

Mr. YOUNG. Thank you.

The CHAIRMAN. Gentlemen, thank you very much for your candor and your contributions here; and I have a hunch that if the level of expertise in American business was the average of what I have seen before me here today, with the kind of track record your two companies have had and the commitment to research and development and sophistication of management, that our trade debt should be a lot less.

Mr. PRATT. Thank you, Senator.

The CHAIRMAN. I really appreciate the time that you have contributed here. It is most appreciated. Thank you both very much.

Mr. YOUNG. Thank you very much.

Mr. PRATT. Thank you, Senator.

[Whereupon, at 12:26 p.m., the hearing was adjourned.]

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